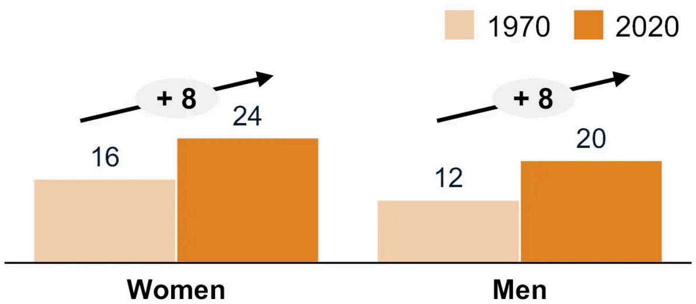
A mature approach

GFIA has measured the massive gap in retirement provision and has recommendations for reducing it

By Sarah Hobbs, chair of the GFIA Ageing Society Working Group

Shifting demographics are one of the megatrends affecting today's risk landscape, particularly in respect of older people. The expected life expectancy of OECD citizens after they stop working, for instance, increased by eight years in just three decades between 1970 and 2020. Yet, on average, pension contributions as a share of GDP remained stagnant in OECD countries between 2008 and 2020, as the number of workers that support pension spending are declining in most of these countries, as populations age and birth rates fall.

Expected life years after labour market exit (OECD countries)



As a result, pension systems across the world are experiencing unprecedented pressures, since they need to sustain more people for longer and at higher standards of living in the context of shrinking working-age populations and therefore shrinking tax revenues.

And these trends will continue; in the USA, for example, 21% of the population is expected to be over 65 by 2030, up from 17% in 2020.

The world’s largest protection gap

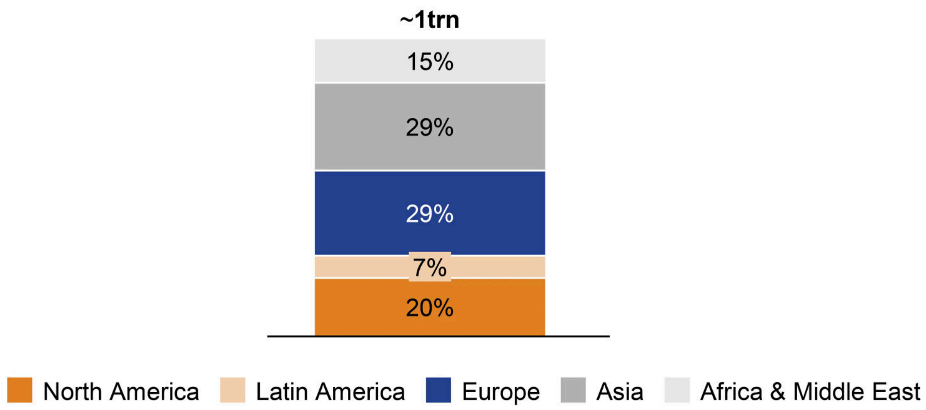
Together the rising pension needs and decreasing inflows into pension systems result in a large and growing pension gap, which GFIA estimated at US$1 trillion annually in a recent study entitled “Global protection gaps and recommendations for bridging them” (see box for more details). The pension gap outstrips the other three large protection gaps that the study identified (for cyber risks, health cover and natural catastrophes).

What is GFIA’s protection gaps study?

To reach the figure of US$1 trillion, GFIA took the difference between the savings needed to sustain a reasonable standard of living (65-70% of pre-retirement income) for the next generation of retirees and the currently projected inflows into the system. This cumulative gap of around US$51 trillion today (excluding pay-as-you-go pension payments and disbursements) was converted into an annuity over 40 years to identify the annual gap.

2-minute watch: Sarah Hobbs on the pension protection gap

Annual pension protection gap (US$trn) and geographic split



Public systems alone are not enough

With pension needs set to continue to grow faster than the available funds, public systems alone are not enough. Indeed, multi-pillar pension systems are widely seen as the most effective way to enhance the sustainability and adequacy of retirement provision, so private providers, such as insurers — who are major providers of a wide variety of occupational and personal pensions — have a significant role to play, while public authorities must also build appropriate regulatory environments and individuals must be encouraged to take more responsibility for their retirement provision.

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There are various potential levers that public and private stakeholders can use to address the pension protection gap.

Insurers, for example, are developing innovative and flexible products that offer a mix of variable and fixed returns and provide access to new types of investments, while reverse mortgage schemes can turn illiquid real estate into a liquid asset. Policymakers have a role to play in supporting the private pension sector, as it is important to avoid capital requirements that undermine providers' ability to invest long-term or offer long-term products and guarantees. It is also vital not to put in place either excessive disclosure requirements that overload potential savers with information or policy measures that inhibit access to advice for consumers who cannot afford to pay fees.

One of the most important actions needed is to raise people's awareness of the need to save — and to save enough — for their own retirement, as well as to help them understand their savings options, since lack of financial literacy hampers pension planning. One successful example in this respect was the educational campaign the Singapore government ran in 2009 when implementing pension income reform. Around 90% of those that attended its educational events said they could apply what they learned.

The introduction of automatic enrolment, as Australia, New Zealand and the UK have done for all citizens in the formal labour force or as the USA has done through enterprise-level regulation, can be highly effective. Participation in the USA 401k pension plan increased by at least 50% due to automatic enrolment, for example. And tax incentives have encouraged employee and employer pension contributions in many countries.

GFIA’s recommendations

In total, GFIA’s study proposes nine recommendations to policymakers of ways to tackle the pension protection gap. These are listed below. Their suitability for each jurisdiction, of course, depends on existing pension systems, cultures and levels of wealth.

DO

- Promote pension savings and educate individuals, especially the young, on the importance and value of saving from the start of their working life.
- Ensure that pension policy is based on a long-term and holistic strategy connected to other policy areas, including employment, housing, taxation and healthcare.
- Incentivise employers to offer pension arrangements.
- Enable part-time, self-employed and gig-economy workers to join retirement saving schemes.
- Ensure regulation that allows digital-friendly delivery and enables providers to meet the evolving needs of consumers.
- Aim for a pension policy that covers accumulation and decumulation with the flexibility to respond to consumers’ needs and circumstances throughout retirement.

DON'T

- Do not create unnecessary regulatory barriers or costs that prevent insurers from providing effective pension solutions.
- Do not impose policy measures that inhibit access to financial advice for less well-off consumers.
- Do not implement policy measures, such as retroactive changes to contract terms, that would defund private pension schemes.

It is only through concerted efforts that the enormous global under-funding of retirement will be reduced. GFIA hopes its study, which provides more detail on the pension gap and on these recommendations, will both raise awareness of the scale of the issue and serve as the basis for discussions with policymakers.

Further reading:

- *“Global protection gaps and recommendations for bridging them”, GFIA, March 2023*

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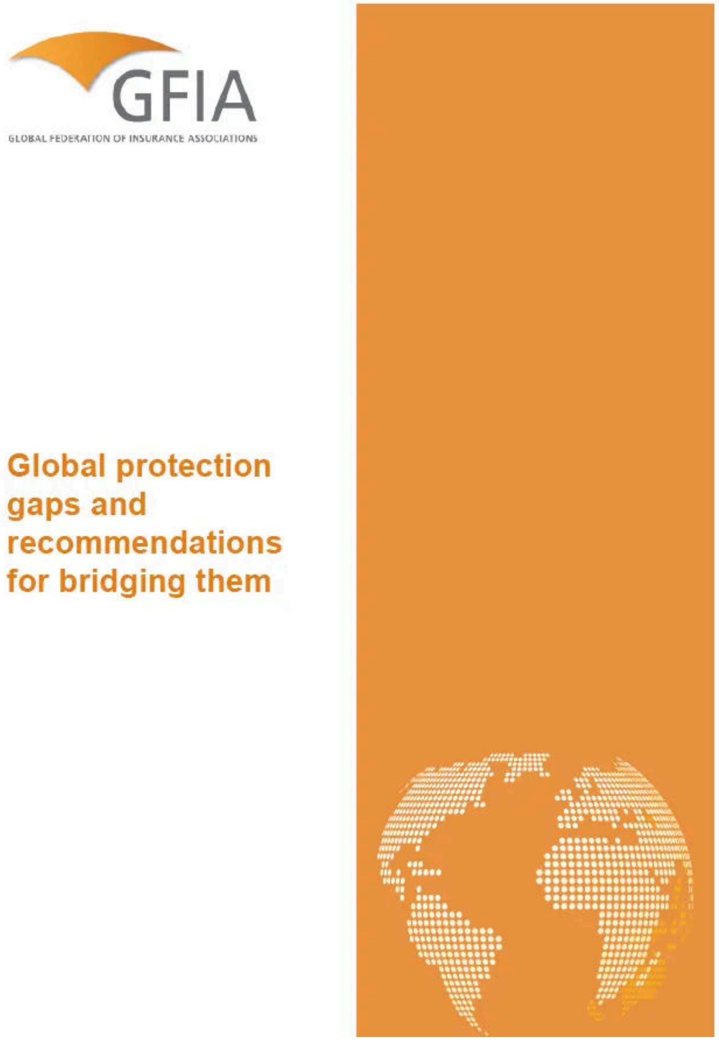

What is GFIA's protection gaps study?

Gaps in protection have major consequences for the well-being and financial resilience of individuals, businesses and society. The world's insurers have a responsibility to understand and communicate the risks that will have the most impact on people's lives. That is why GFIA commissioned the first-ever study to identify and quantify the largest global protection gaps and to make recommendations for how policymakers and insurers can work together to close them.

The study, "Global protection gaps and recommendations for bridging them", was published in March 2023. It identified four gaps that have the most impact on people's lives due to their size, global presence, impact on livelihoods and expected growth. They are: gaps in pension provision (US$1trn); cyber-risk protection (US$0.9trn); health cover (US$0.8trn); and protection against natural catastrophes (US$0.1trn).