

# CHAPTER 1

## EXECUTIVE SUMMARY

The provision of financial security in retirement is critical for both individuals and societies as most countries are now grappling with the social and economic effects of ageing populations. Yet, a comparison of the diverse retirement income systems around the world is not straightforward. As the OECD (2011) notes: “retirement-income systems are diverse and often involve a number of different programmes. Classifying pension systems and different retirement-income schemes is consequentially difficult.”<sup>1</sup>

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1. OECD (2011), *Pensions at a Glance: Retirement-income systems in OECD and G20 countries*, OECD Publishing, p106.

Furthermore, comparing these systems is certain to be controversial as every system has evolved from each country's particular economic, social, cultural, political and historical circumstances. There is no perfect system that can be applied universally around the world. However there are certain features and characteristics of retirement income systems that are likely to lead to improved benefits for individuals and households, an increased likelihood of future sustainability of the system, and a greater level of confidence and trust within the community.

This study of 16 countries has confirmed that no system is perfect. Indeed, consistent with our previous two reports, no country's system has received an overall index value above 80, which we consider represents an A-grade retirement income system. However, several countries have an index value between 65 and 80, which represents a B-grade system and — with some adjustments or improvements — these countries could be re-classified

as A-grade systems. (Changes that would raise each of these systems to the A-grade level are discussed in the final chapter.) Furthermore Chapter 4 describes the features of an A-grade system and shows that it is possible for developed economies with appropriate policies to reach this highest or gold standard.

We believe that none of the countries in this pilot study has an E-grade system, which would be represented by an index value below 35. A score between 35 and 50, which represents a D-grade system, indicates a system that has some sound features but where there exist major omissions or weaknesses. A D-grade classification may also occur in the relatively early stages of the development of a particular country's retirement income system, such as China and India.

This year we have also introduced B+ and C+ grades to highlight that certain countries are approaching A and B grades respectively.

The following table summarises the results.

Grade	Index Value	Countries	Description
A	>80	Nil	A first class and robust retirement income system that delivers good benefits, is sustainable and has a high level of integrity.
B+	75–80	Netherlands Australia	A system that has a sound structure, with many good features, but has some areas for improvement that differentiates it from an A-grade system.
B	65–75	Switzerland Sweden Canada UK	
C+	60–65	Chile	A system that has some good features, but also has major risks and/or shortcomings that should be addressed. Without these improvements, its efficacy and/or long-term sustainability can be questioned.
C	50–60	Poland Brazil USA Singapore France Germany	
D	35–50	Japan India China	A system that has some desirable features, but also has major weaknesses and/or omissions that need to be addressed. Without these improvements, its efficacy and sustainability are in doubt.
E	<35	Nil	A poor system that may be in the early stages of development or a non-existent system.

It should also be noted that each country's index value takes into account more than 40 indicators, some of which are based on data measurements which are difficult to compare between countries. For this reason, it is suggested that one should not be too definite that one country's system is better than another when the difference in the overall index value is less than two.

On the other hand, when the difference is five or more it can be fairly concluded that the higher value indicates a country with a better retirement income system.

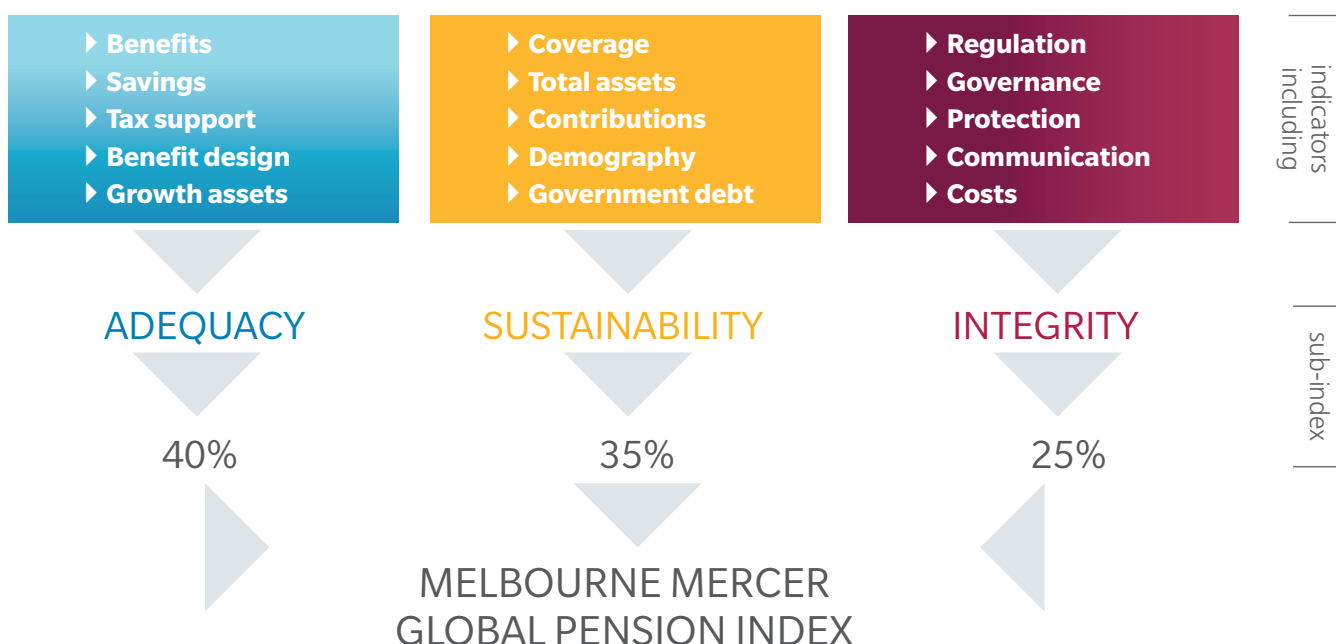
The following table shows the overall index value for each country, together with the index value for each of the three sub-indices: adequacy, sustainability and integrity. Each index value represents a score between zero and 100.

Country	Overall Index Value	Sub-Index Values		
		Adequacy 40%	Sustainability 35%	Integrity 25%
Australia	75.0	73.6	71.4	82.4
Brazil	58.4	71.0	27.3	81.7
Canada	69.1	74.1	55.8	79.7
Chile	64.9	53.1	67.8	79.8
China	42.5	48.1	30.6	50.1
France	54.4	73.6	30.7	56.8
Germany	54.2	63.5	36.4	64.4
India	43.4	37.3	39.4	58.8
Japan	43.9	44.1	28.4	65.2
Netherlands	77.9	75.9	70.8	91.4
Poland	58.6	64.3	40.7	74.5
Singapore	56.7	41.9	60.9	74.5
Sweden	72.6	65.6	75.4	79.9
Switzerland	72.7	70.4	67.7	83.5
UK	66.0	67.8	50.8	84.5
USA	58.1	58.7	54.4	62.5
<b>Average</b>	<b>60.5</b>	<b>61.4</b>	<b>50.5</b>	<b>73.1</b>

The overall index value represents the weighted average of the three sub-indices. The weightings used are 40 percent for the adequacy sub-index, 35 percent for the sustainability sub-index and 25 percent for the integrity sub-index. The different weightings are used to reflect the primary importance of the adequacy sub-index which represents the benefits that are currently being provided together with some important benefit design features. The sustainability sub-index has a focus on the future and measures various indicators which will influence the likelihood that the current system will be able to provide benefits that are maintained in the future. The integrity sub-index has a focus on the private sector pension system and therefore has a more restrictive scope than the other two sub-indices. Nevertheless the private sector represents a critical component in most country's overall system as the public pillar cannot be expected to provide adequate benefits for all over the longer term.

Four countries, namely Australia, Chile, China and the UK, have improved their index value by at least two points this year for a variety of reasons. Australia raised its base pension and increased its net household saving rate while the pension coverage in Chile has increased significantly. China's improvement was primarily caused by new decrees relating to pension plans. On the other hand, several improvements in the UK including a higher net replacement rate, increased housing savings and an improvement in pension coverage all played their part in the improvement of the index value for the UK.

## Calculating — the Melbourne Mercer Global Pension Index



Chapter 8 makes several suggestions to improve each country's retirement income system. Although each system reflects a unique history, there are some common themes as many countries face similar problems in the decades ahead. These common challenges include the need to:

- Increase the state pension age and/or retirement age to reflect increasing life expectancy, both now and in the future, and thereby reduce the level of costs of the publicly financed pension pillar
- Promote higher labour force participation at older ages including the provision of phased retirement, particularly as many individuals now remain in good health for longer periods
- Encourage or require higher levels of private saving, both within and beyond the pension system, to reduce the future dependence on the public pension
- Increase the coverage of employees and/or the self-employed in the private pension system, recognising that many individuals will not save for the future without an element of compulsion or automatic enrolment
- Reduce the leakage from the retirement savings system prior to retirement thereby ensuring that the funds saved, often with the associated taxation support, are used for the provision of retirement income.

These challenges relating to both adequacy and sustainability remain unchanged from our first index report (Mercer (2009)) highlighting the long term nature of these issues.

It is interesting to note that Jackson et al (2010) of the Center for Strategic and International Studies concluded from their work on the Global Aging Preparedness Index that whilst there are many strategies available to address the economic and social challenges of an ageing population, two in particular can be win-win solutions. They are "extending work lives and increasing funded retirement savings." Both these developments would improve a country's adequacy and sustainability sub-index values through higher retirement ages, increased labour force participation at older ages, greater pension coverage, higher contribution rates, increased savings and a higher level of pension assets.

More recently Karam et al (2011) of the IMF have noted that "The pension reform with the most positive long-term economic effects is one that extends people's working years." They also add that the impact of a cooperative approach to age-related fiscal reform is greater than when only one region undertakes reform. We agree. These challenges are not restricted to a single country or region. They are global and need to be considered within that context.