Pre-funded pensions in developing countries: Experience and challenges

Philip O'Keefe

Centre of Excellence for Population Ageing Research (CEPAR)
UNSW

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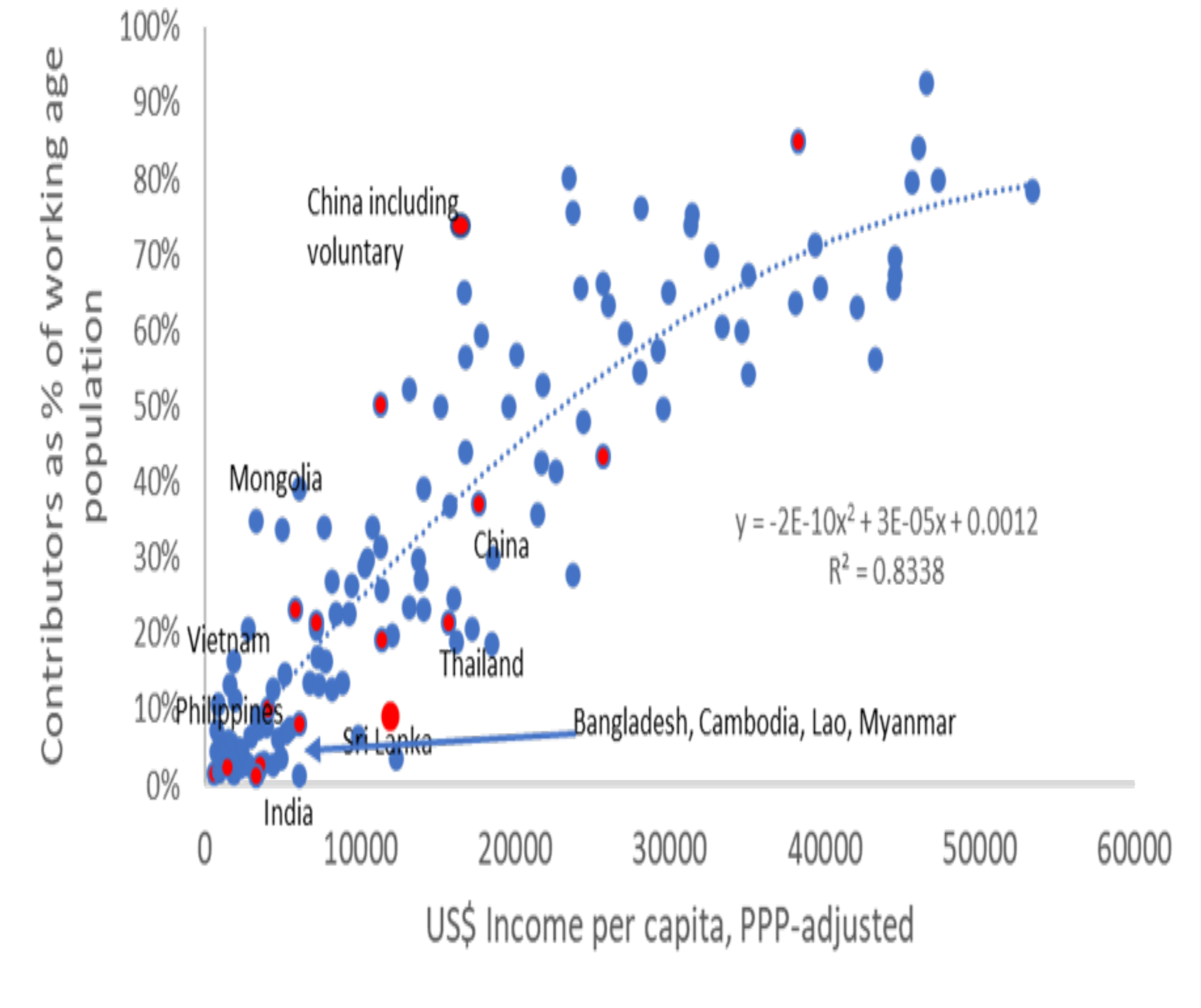
Outline

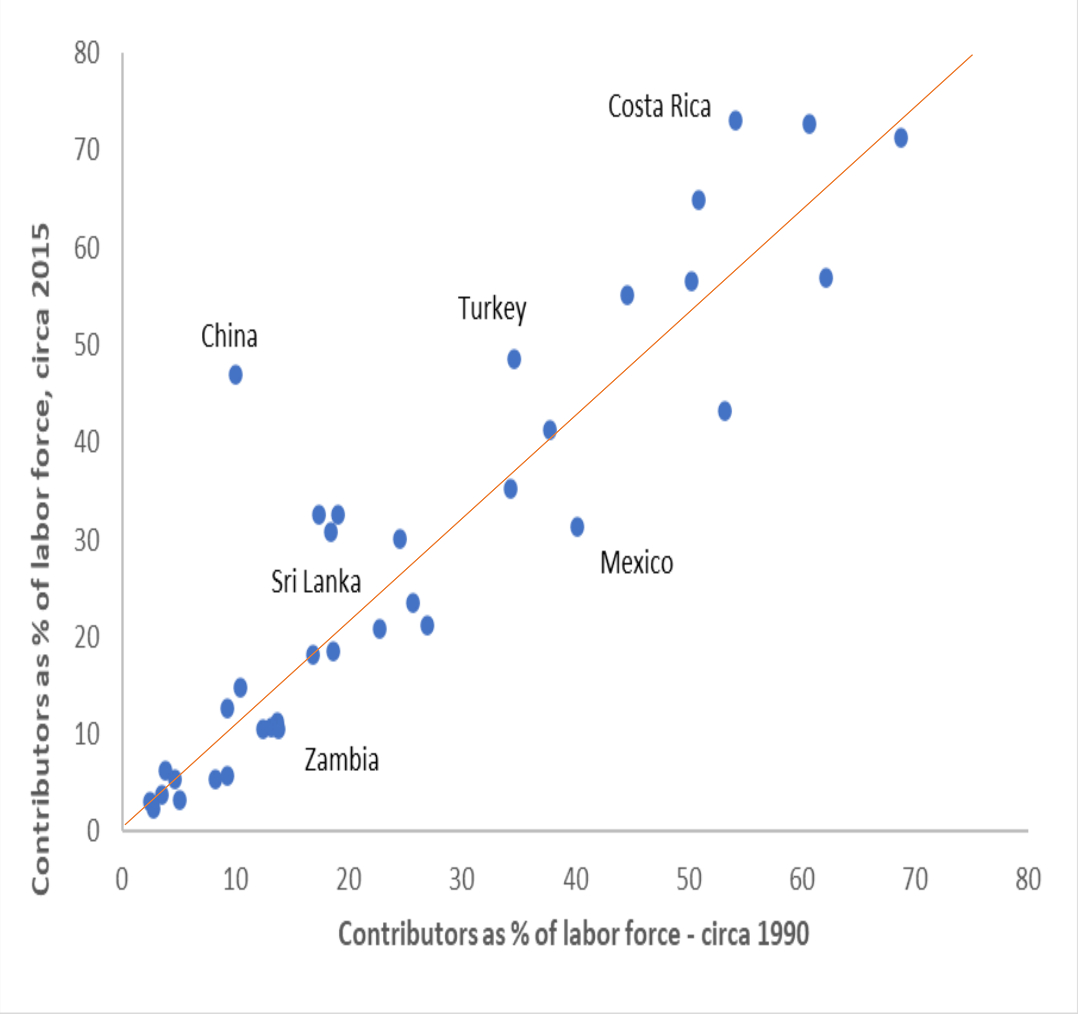
- Context
- Pre-funded schemes in developing countries and common challenges
- Pre-funded schemes for the informal sector

No matter the funding type, coverage has generally remained low in developing countries…

Contributors to WAP by country income level, latest year

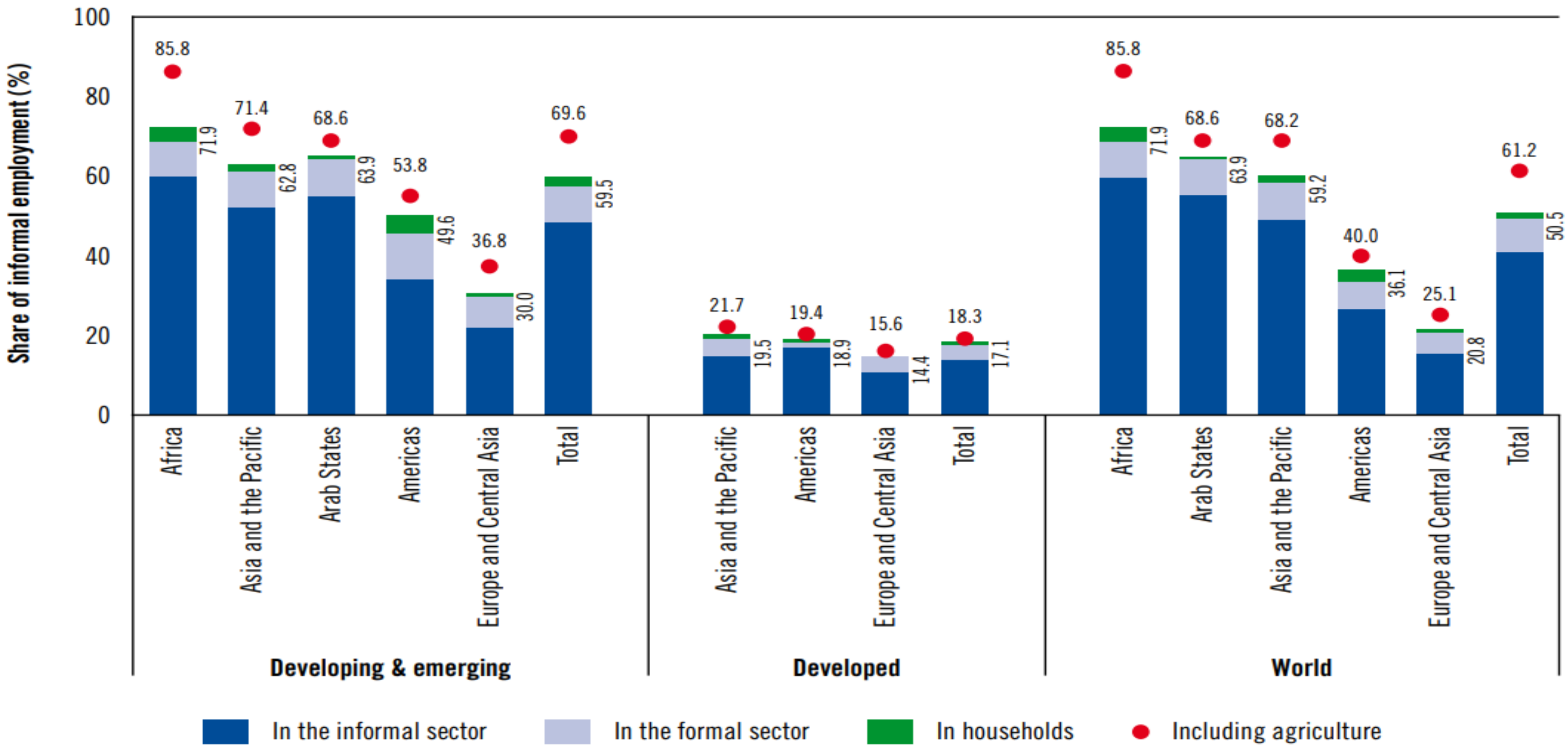


Contributory pension coverage 1990s vs. 2015

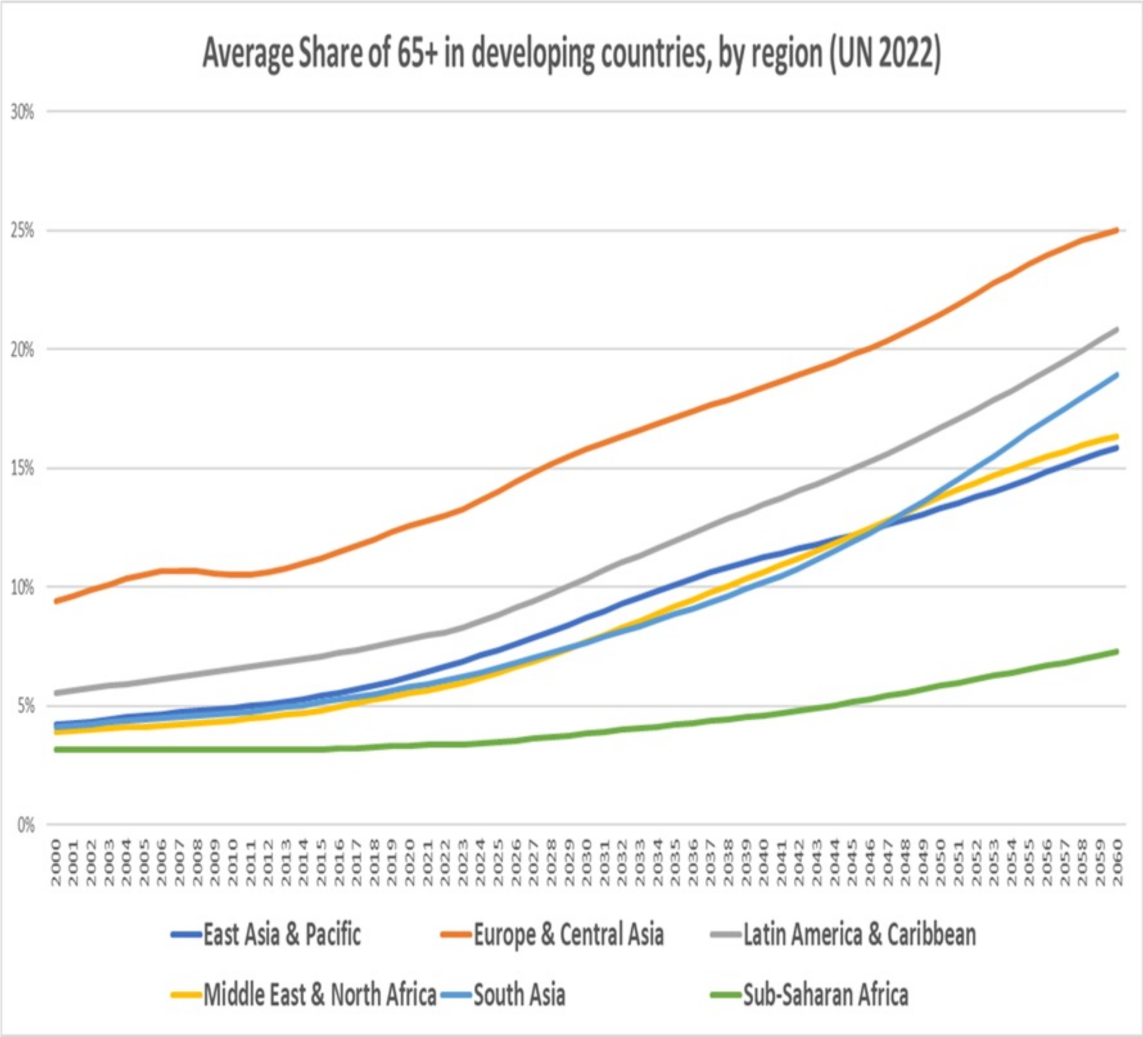


Source: WB pensions DB

Coverage closely reflects levels of labor market informality…which remain stubbornly high



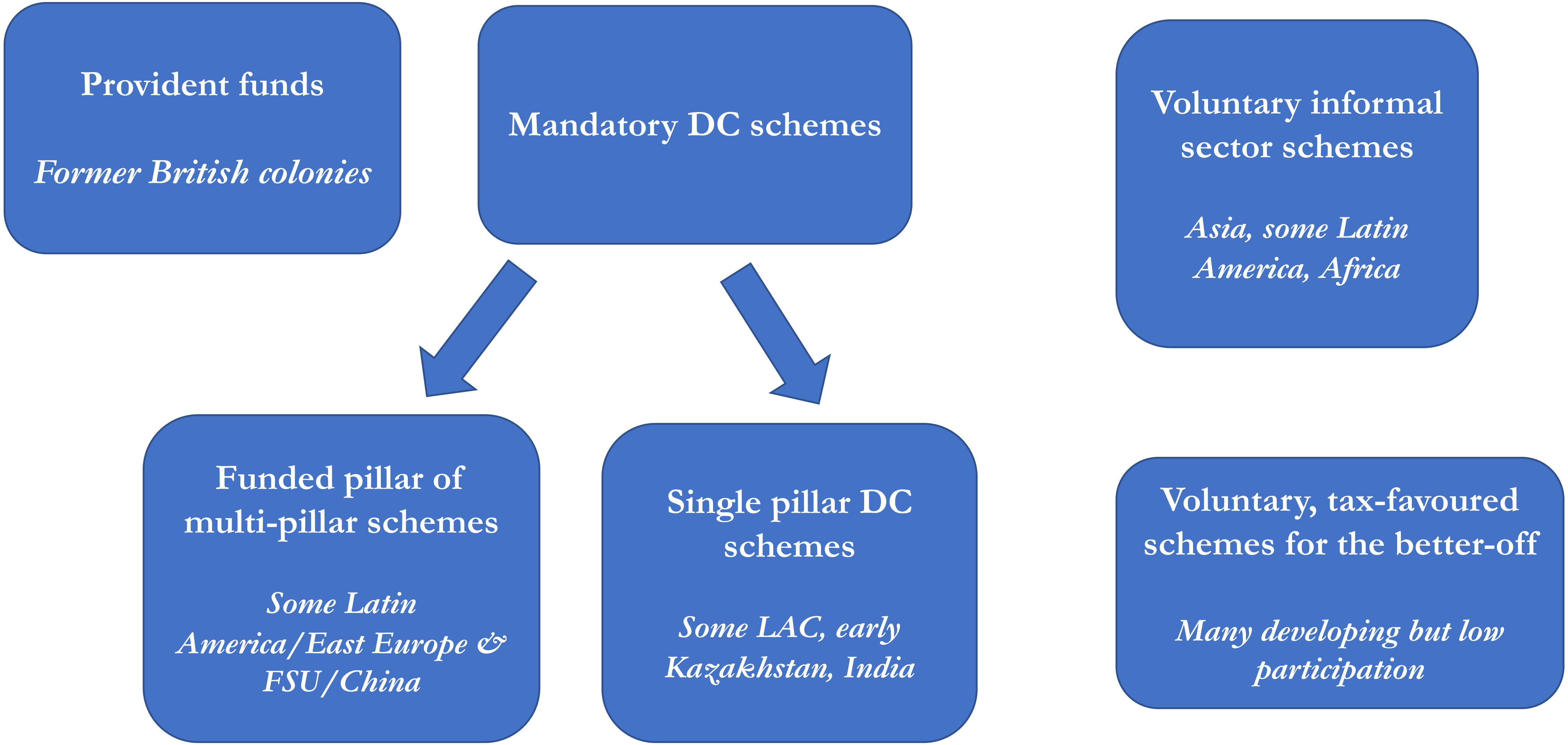
As a result, most developing countries are losing the race between coverage expansion and demographic transition…



- There will be 1.5 bln people 65+ years in developing countries by 2060: 1 billion more than today
- Of whom, those 80+ will more than quadruple to over 400 million
- Over 2/3 of older people globally live in developing countries & they will account for almost 80% by 2050

Pre-funded pensions with informality & non-standard employment

Key forms of pre-funding arrangements in developing countries



Legal, governance, and administrative arrangements are key to building & retaining trust…but not assured

- For funded schemes – formal or informal – robust governance arrangements and sustained political commitment are especially important, perhaps even more so for informal workers who participate voluntarily & trust the scheme

- Political risk has presented in various ways: funded scheme reversals & dilutions; outright capture of individual accounts (e.g., Argentina, Hungary); politicization of governance; shifting informal schemes with political change (e.g., India)

- Other pre-conditions for successful pre-funding – a reliable collection mechanism and access to diversified capital markets – are often not present in developing countries, the latter for fiscal, political and (sometimes) under-development reasons

- Reliance on competition to drive down costs & promote returns has proven specially challenging in environments of low financial literacy and weak regulatory capacity

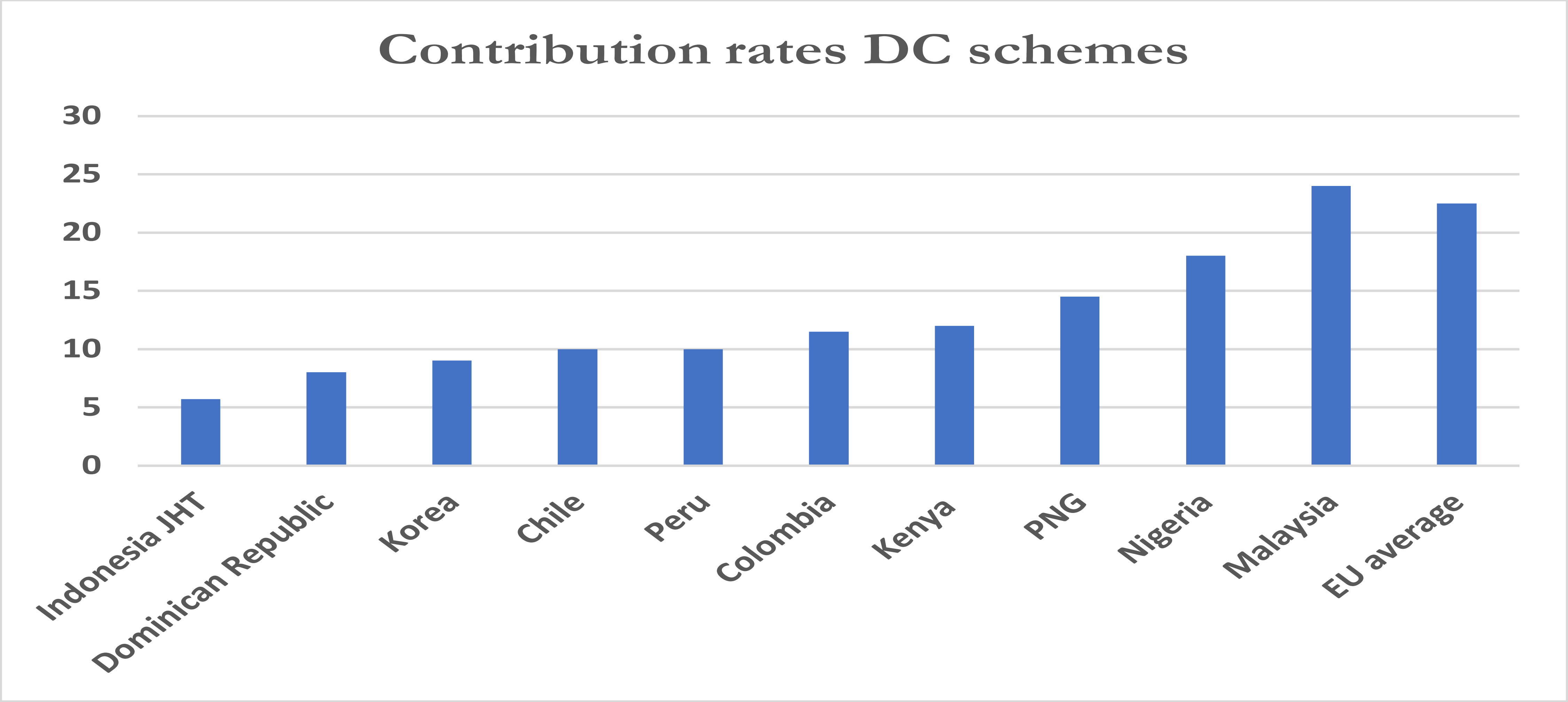
What we know from formal sector funded schemes in developing countries…

- **Coverage** has remained partial – and partly linked to business cycle

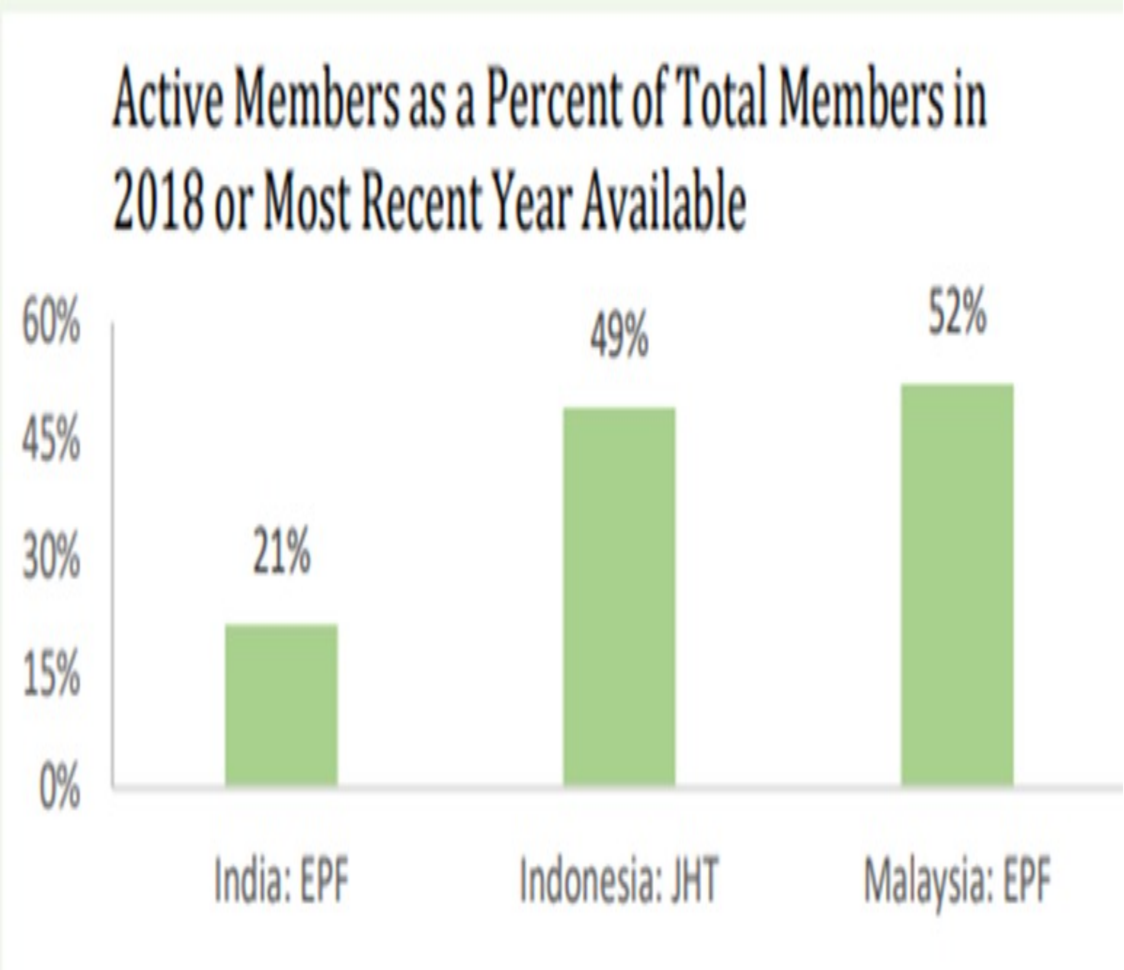
Adequacy a major challenge for variety of reasons:

- For some countries, low contribution rates
- Low active contributor shares biased to higher income groups
- Poor density even among active contributors
- Early withdrawal rules
- For some countries, low returns and high management fees

For some countries, contribution rates are too low to ensure adequacy without high returns…



Inactive accounts are often significant …particularly for lower income groups & women



Source: GAI, based on fund annual reports

Active members as share of total members by income quintile, c.2020

	Uruguay	Chile	Mexico	El Salvador
Q1	48	10	10	0
Q2	56	10	10	0
Q3	67	30	30	35
Q4	76	50	70	70
Q5	84	90	90	100

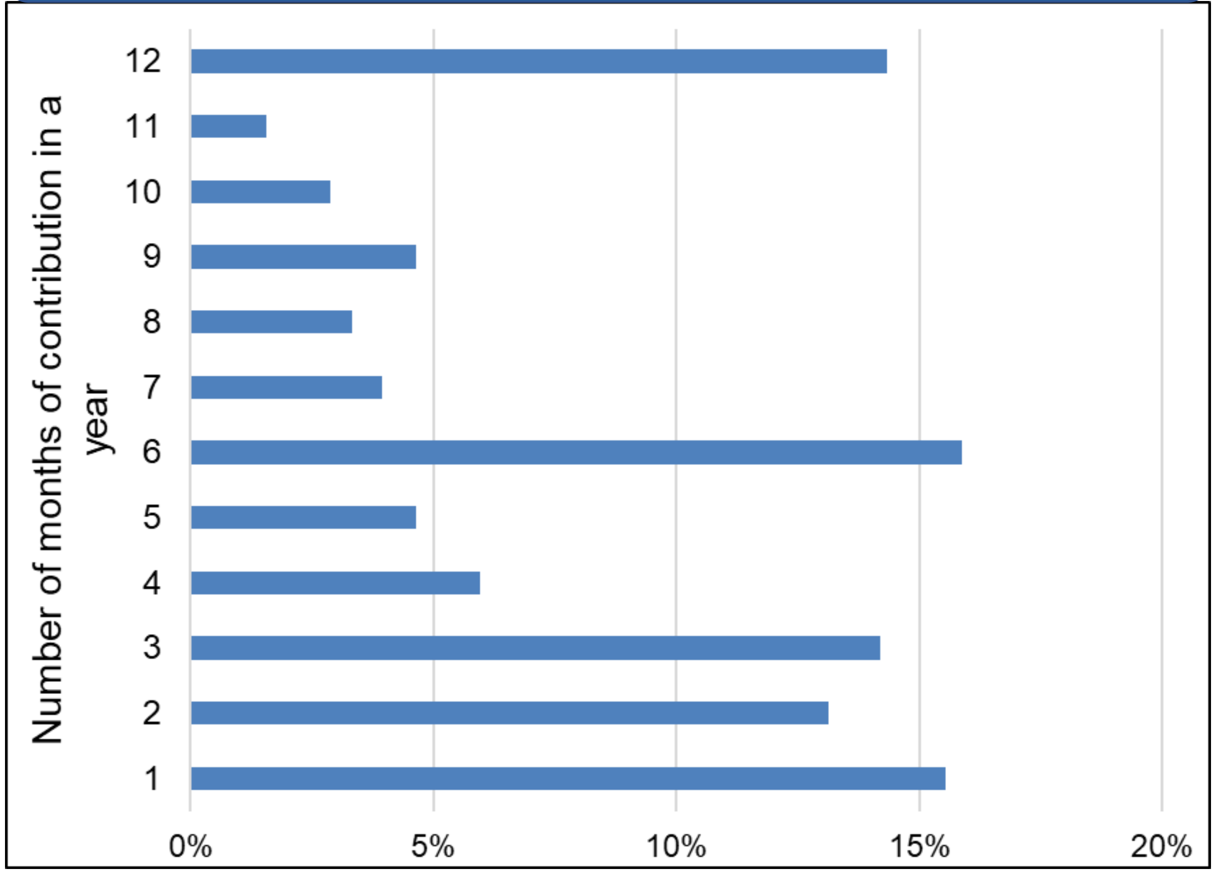
Source: World Bank forthcoming

Among actives, major challenges of density in formal and informal sector schemes…reflecting nature of work

	Mean contribution density
Uruguay	66%
Mexico	41%
Chile	38%
Argentina	32%
Peru	35%

Source: National administrator data

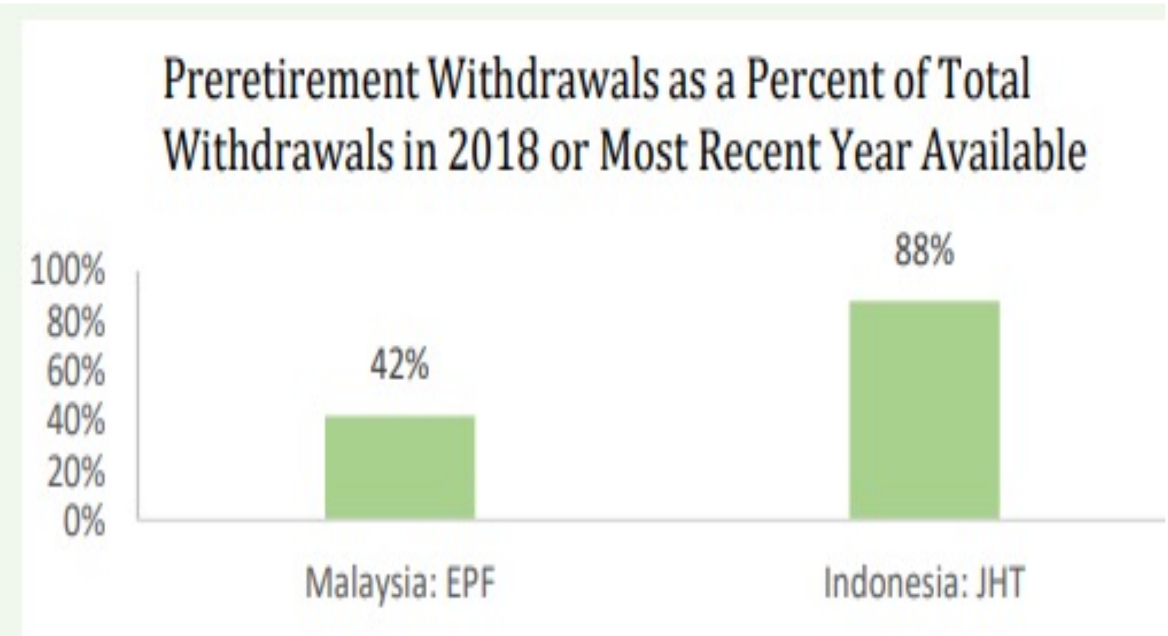
Vietnam voluntary informal scheme, active contributors by months of contributions, 2019



Source: Vietnam VSIF administration

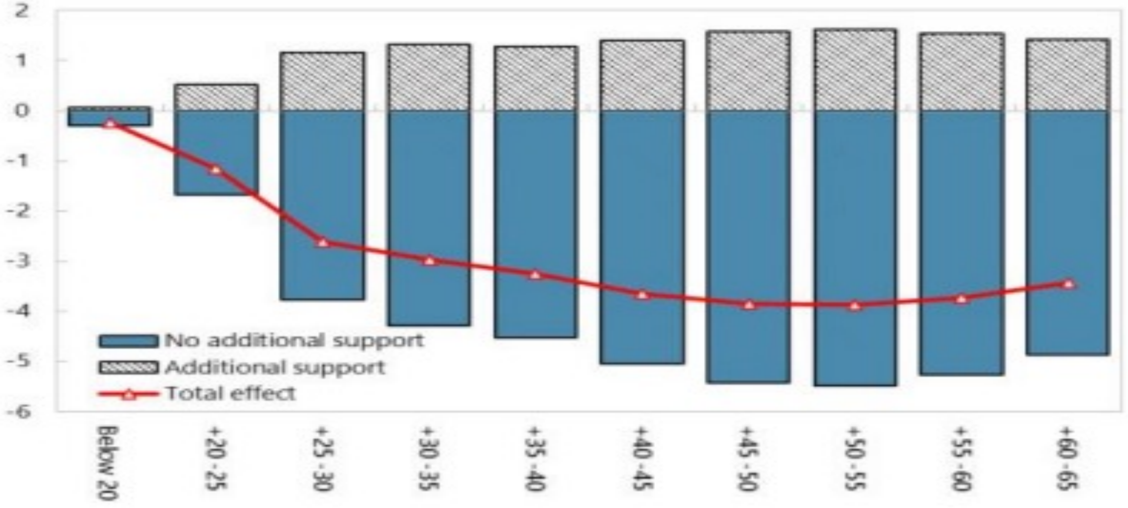
Early withdrawals

- Common feature of developing country provident funds/schemes for hardship reasons, and widespread use of COVID withdrawals
- Some through sidecar accounts and others through general account
- Challenges for investment management due to higher liquidity needs

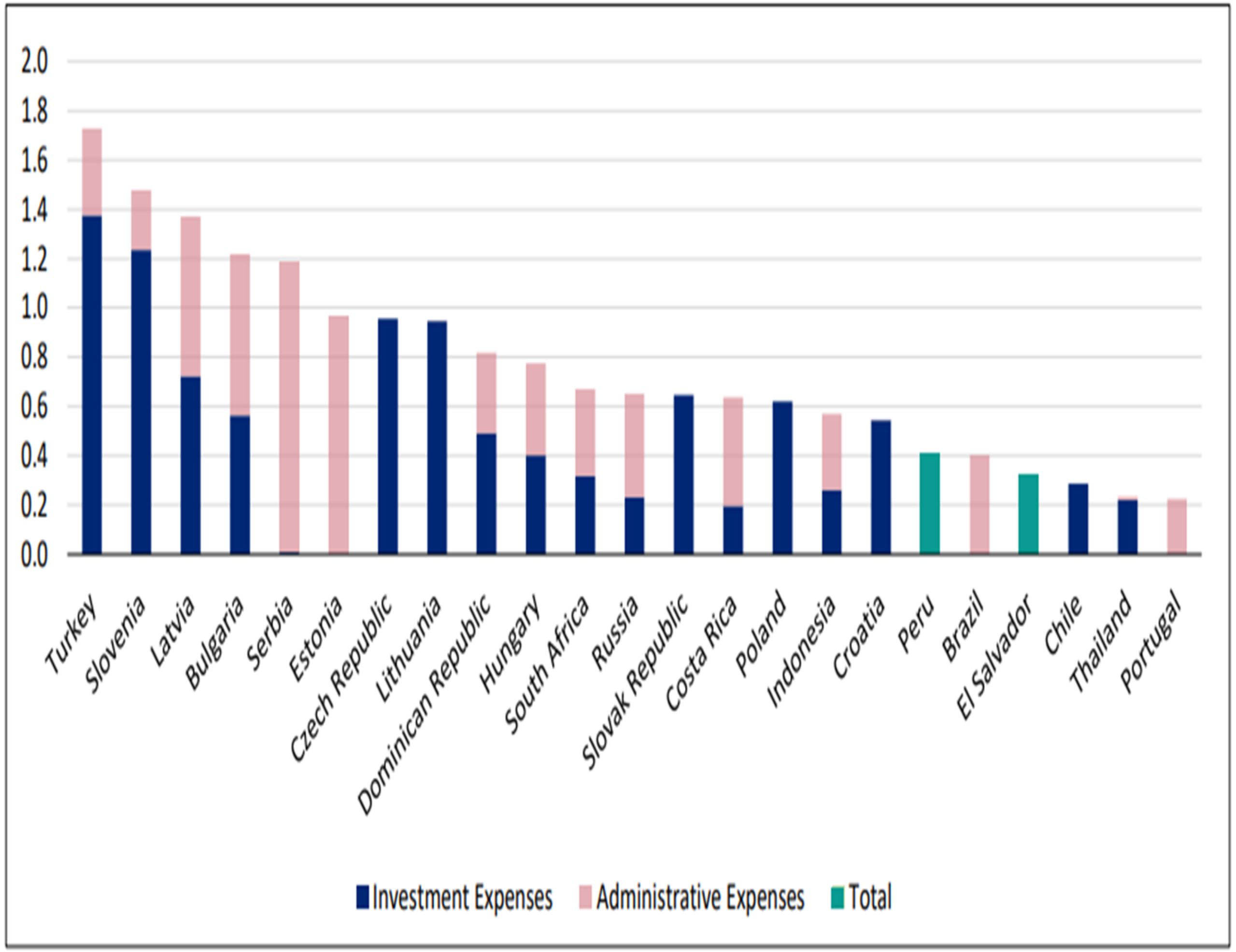


Source: GAI, 2021

Chile COVID withdrawals RR reduction by cohort, men (IMF, 2021)



Large variations across developing countries in management fees & returns…impacting adequacy



Source: AIOS, 2019. Monthly Statistics; OECD Global Pension Statistics.

- **For returns**, most common issue remains conservative portfolio rules which prioritize government bonds & bank deposits, but this is shifting
- International diversification remains limited in many developing countries but rising (e.g., Chile, Malaysia, Kosovo)
- Life cycle allocation largely absent

Decumulation phase has received less attention in most schemes, with focus primarily on coverage expansion…

- Many developing countries still rely on lump sum withdrawals in formal & informal schemes, with limited reliance on annuities or phased withdrawals – in part due to very low balances

- Mandatory DC schemes in countries with functioning annuities provide options to purchase annuities (e.g., Chile for example) or are considering phased withdrawal (e.g., Malaysia EPF), but demand may be limited even when choice of lump sum or annuity/phased withdrawal is offered (e.g., Nigeria)

- For voluntary DB schemes (India, Vietnam, China), indexation varies, from none (India) to ad hoc (China residents' pension) to same mixed indexation as main scheme (Vietnam).

The spread & initial experience of informal sector schemes

The rise of informal sector retirement savings schemes…

- In response to the limited success in expansion of formal contributory schemes, there has been a wave of **voluntary retirement savings programs targeted to informal sector workers:** Asia, Africa and LAC

- Usually parallel informal sector schemes – though some *in principle* have portability with formal sector schemes (e.g., China, Rwanda and Kenya)

- Mostly DC design and often with contribution incentives and matches, though also hybrid schemes combining partial funding through individual accounts and defined benefit as the "carrot" (e.g., China residents' pension scheme)

- Typically government operated, often administered by the formal sector pension agency or provident fund, with administrative cross-subsidies from formal to informal schemes

Take-up has so far tended to be modest in absolute terms, though sometimes *relatively* significant…

Country/scheme	Informal scheme WAP coverage	As share main formal sector scheme coverage
Vietnam **VSIF**	**3.2%**	12%
Thailand **SSF (1999), NSF (2011) RMF**	**12%**	56%
India **NPS lite (2000), APY (2015), PM-SMY (2020)**	**5.3% (total across schemes)**	66%
Colombia	**5.2%**	15%
Rwanda Ejo Heza	**34%**	425%

Rwanda a surprise package: Ejo Heza Long-Term Savings Scheme introduced in 2018

- **DC scheme covering 34% of working age population: of whom 87% are informal sector workers & around half are women**
- 100% match for poorest households and 50% for vulnerable HHs if they meet a minimum savings threshold
- Bundled with life insurance & funeral benefit
- Strong reliance on cooperatives as aggregators
- Strong central digital platform interoperable with national ID & social safety net databases
- Nonetheless, average savings levels remain low to date

Innovations to improve informal sector participation in pre-funded schemes in almost all schemes…

Various approaches being used - often in combination:

- Financial incentives through contribution matching by government
- Bundling of retirement savings products with short-term benefits
- Simple and flexible design & leveraging ID and digital platforms
- Reliance on aggregators
- Public information and financial literacy initiatives to explain products and promote participant retention

Contribution matching levels and forms vary

Matching rates vary across (and sometimes within) countries:

- ***in rates***, from as low as 10% match up to 100% (e.g., India, Rwanda for poor households). Match may vary by poor/near-poor/non-poor (e.g., Vietnam)
- ***in period***, from limited maximum terms (e.g., India and Vietnam) to open-ended
- ***in structure***, with hybrids of upfront match and ex post match through subsidized defined benefit at fixed age (e.g., China residents' pension)

Little research to date on elasticity of take-up to match & impacts of different matching structures

Bundling retirement savings with short term programs and early access…

Bundling with short term benefits a common strategy to address liquidity constraints and myopia:

- Bundling with non-retirement programs, often health cover, but others including life insurance, maternity, micro finance, loan collateral etc.

  e.g., Benin bundles pension, health, microfinance and training, with analytics tools for insurance companies & MFIs to target groups with specific combinations

- Division of accumulations into long term and sidecar accounts with withdrawals for specified contingencies (health shocks, housing, education etc), e.g., Malaysia 70/30; Ghana 50/50 between LT and ST accounts

Simple and flexible scheme design & leveraging ID & digital platforms…

- ***Flat, tiered or flexible contributions***, often capped
- ***Flexible contribution periodicity*** from weekly to annual – and micro-contributions
- ***Simplification of KYC requirements*** for opening accounts, e.g., India APY leveraging of biometric National ID to identify customer and online services to send enrolment forms
- ***Auto-enrollment***, more common in DB schemes like in India, or Vietnam's scheme. Some DC schemes can enforce auto-enrollment if the aggregator agrees (Rwanda with cooperatives, Kenya Haba Haba with transport association). India APY auto-debiting also
- ***Expansion of contribution channels***. Growing reliance on mobile money accounts for contributions (e.g., Kenya Mbao scheme using MPESA & Airtel Money); Whatsapp (India's NPS, Gift a Pension); Mexico reliance on convenience stores with connection to private pension fund administrators
- ***Financial literacy programs*** leveraging mobile phones, social media etc.

Partnerships with aggregators…

Aggregators often key to achieving economies of scale in collections and promotion of schemes:

- ***Cooperatives, industry associations of informal workers, self-help groups***
  - In Rwanda 85% of all informal sector members are from cooperatives and is one of the reasons behind high rates of active account in Ejo Heza
- ***Financial institutions***, including MFIs, banks & insurance companies
  - In APY scheme (India) all members need to have a bank account to be a member of the scheme. Banks get a minimum commission of Rs.100 on each application and promotional incentives for higher volume account opening.
- ***Retail points-of-sale***. e.g., Mexico with central switch to connect convenience stores across the country to private pension fund administrators
- ***Telcos/mobile operators,*** e.g., Kenya M-PESA

A final word…

- Pension schemes cannot solve the fundamental issues of high informality and low & irregular incomes. Do not (as in past DC waves in Latin America) expect funding to drive labor market formalization, but accept the situation and adapt designs and administration accordingly

- The perennial problem of adequacy is unlikely to go away – making coherence of funded scheme designs with social pensions a key question for policy and administration

Thank you

谢谢 धन्यवाद Gracias

Cảm ơn bạn Asante Terima kasih