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How We Can Save (for) Our Future

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Contents

Foreword

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The challenges to provide ageing populations with a financially secure retirement are well known. Recent trends in retirement system design and changing workforce dynamics mean individuals are taking more responsibility and risk to achieve adequate incomes in retirement. At the same time, many individuals do not have easy access to retirement savings vehicles. Society must ensure retirement systems are inclusive and sustainable, and provide adequate income for all. Achieving this balance is challenging but lessons can be learned from successful systems around the world.

This White Paper has been produced as part of the World Economic Forum Retirement Investment Systems Reform project, which has brought together pension experts to assess opportunities for reforms that can be adopted to improve the likelihood of retirement systems adequately and sustainably supporting future generations. The issues and findings discussed are the result of numerous interviews, discussions and workshops.

With this in mind, we thank Mercer, our project partner, as well as our Steering Committee and Expert Committee for their input, which has allowed us to draw on expertise from different communities and knowledge networks.

Introduction

Retirement systems worldwide are currently under strain. While examples of progress made to improve systems are numerous, further reforms are required in many parts of the world to ensure they are sustainable, inclusive and able to provide future generations with financial security in their retirement.

Over the last two years, the World Economic Forum has been working with experts from around the world to assess the challenges facing retirement systems globally (covered in the 2017 White Paper, "We'll Live to 100 – How Can We Afford It?") and exploring the solutions that can be implemented to close the savings gap (focused on in this paper).

The retirement savings gap is a global challenge

The magnitude of the global retirement challenge was highlighted in the previous paper, in which the shortfall in pension savings (the retirement savings gap) for the eight largest pension markets was estimated at $70 trillion. While improvements in longevity should be celebrated, longer lifetimes are ultimately increasing the cost of retirement, and hence the savings gap is projected to increase significantly. If measures are not taken to increase overall levels of savings, this gap is projected to grow to $400 trillion by 2050.

Key challenges facing retirement systems include:

- **Greater longevity**, resulting in higher levels of savings required to sustain longer lifetimes and **ageing populations**, putting a strain on the sustainability of pay-as-you-go systems
- **Increasing responsibility for individuals** to ensure adequate retirement income, largely driven by trends among governments and employers to move away from traditional defined benefit (DB) systems towards defined contribution (DC) systems. Also, trends in labour markets are resulting in less traditional employment patterns and more contingent and self-employed workers who are unlikely to have access to employer-facilitated plans
- **Low levels of savings** by individuals
- **Poor financial literacy** in an environment where responsibility has shifted to individuals
- **A lower expected investment return environment**, placing more importance on the level of contributions
- **Lack of access** to savings vehicles – one of the biggest barriers to saving for retirement.

Figure 1: Size of the retirement savings gap, 2015-2050 (trillion $)

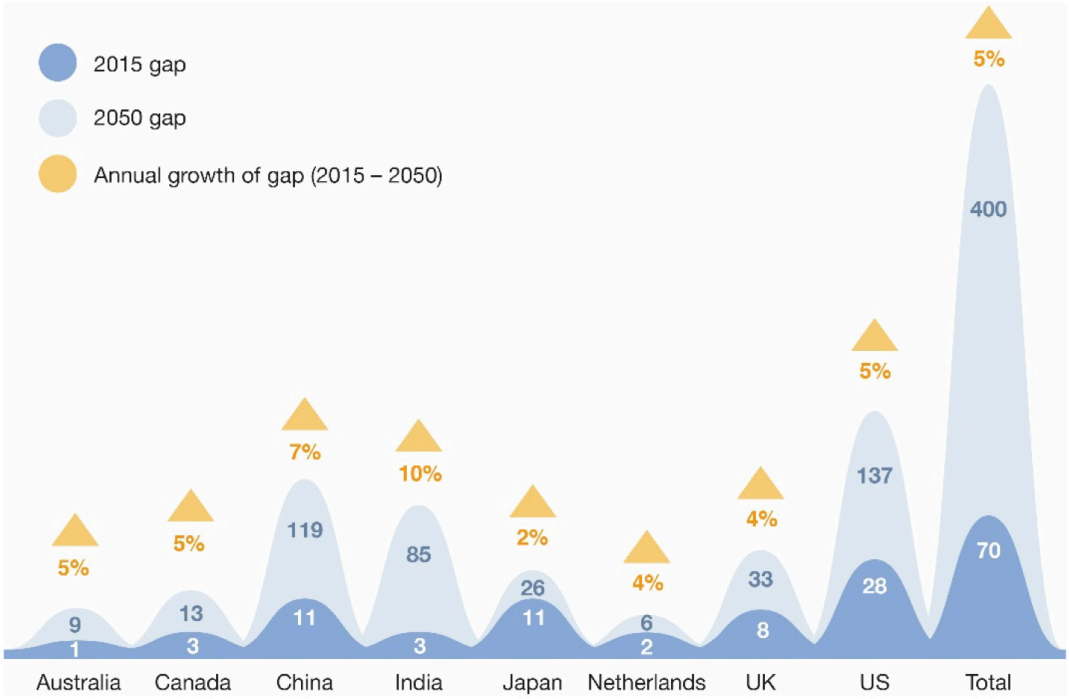
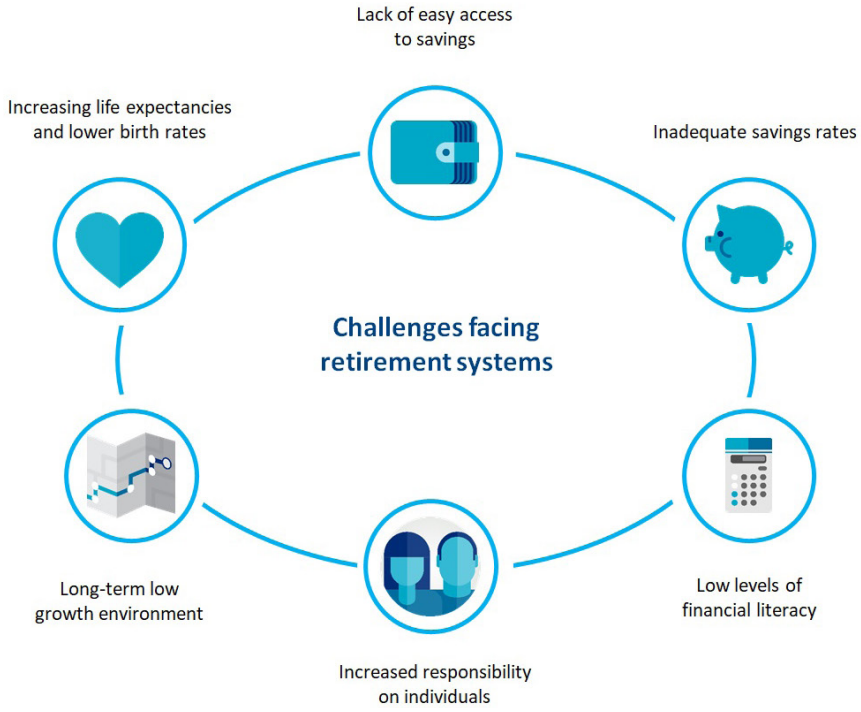


Figure 2: Challenges facing global retirement systems

Source: Based on World Economic Forum, "We'll Live to 100 – How Can We Afford It?", Figure 3



What can be done to close the gap?

The trend away from traditional DB and towards DC systems includes a significant shift in risk ownership from the traditional providers, governments and employers to individuals. Given this trend, this paper focuses on the solutions DC retirement systems can implement to improve retirement security.

A key finding in the first paper was that expanding access to retirement savings vehicles is one of the most effective means to address the global retirement crisis. Without easy access, and in the absence of auto-enrolment or mandates, individuals are less likely to save. While ensuring that individuals have access to the tools needed to plan for retirement is important, effectively engaging them to participate in the first place is critical. In addition, financial innovation is necessary to make sure that savings can be invested in low-cost products that can produce a stable and sufficient retirement income.

This White Paper includes findings on techniques that system providers (i.e. governments and employers) can use to close the savings gap, from increasing coverage to adopting digital financial systems. Given that the retirement savings gap is largest in the United States, a case study is included on the challenges facing US retirement systems and the lessons that can be learned from various countries. This paper concludes with recommendations for policy-makers and plan providers for closing the savings gap and improving retirement security.

Best practice plan design features

The following three key principles have been identified to make progress towards financial inclusion and improved retirement security:

A. Expand coverage to more individuals
   - Employer-facilitated plans
   - Low-income populations
   - Women

B. Leverage technology to increase levels of savings
   - Structure pension systems to provide incentive to improve participation
     - Use automatic design features to help improve retirement outcomes
     - Address the need for emergency cash

C. Structure pension systems to provide incentive to improve participation

It is important to bear in mind that no one-size-fits-all solution exists when designing retirement systems. Regional, political and cultural attitudes provide many differentiating influences. This section is intended to serve as guidance and to highlight the importance of remaining mindful of the intended audience and the regulatory framework in which the system is created.

A. Expand coverage to more individuals

Many individuals in both developed and developing markets still lack easy access to pension plans and saving products. In many cases, options are available but take-up is low. The lack of opportunity to begin saving and the lack of encouragement to develop savings habits severely limit many people's ability to accumulate sufficient retirement savings. Recently released research from Mercer shows that, globally, only 25% of individuals are confident they can save enough for retirement, and two-thirds do not ever expect to retire.[1]

Ensuring that all individuals have access to retirement savings vehicles is key to reducing the savings gap. Systems need to ensure that marginalized groups (e.g. self-employed, contract workers, informal workers, disabled, low-income) have easy access to the tools needed for a financially secure retirement.

Employer-facilitated plans

Using America as an example, approximately 50% of workers in the private sector do not have access to an employer-facilitated retirement savings plan.[2] In addition, those working at smaller companies, where regulation and cost may make providing a plan overly burdensome for employers, are also at a disadvantage.

Employer-facilitated plans can have a big impact on retirement savings; research shows individuals are 15 times more likely to save if their employer offers a plan.[3] Mercer's Healthy, Wealthy and Work-wise research shows that individuals trust their employers more than third-party providers. Using employers to encourage individuals to save for retirement is one of the most effective means of expanding access.

Considerations for employer plans:

- **Maximize the role of the employer:** Mandatory compliance has been used effectively around the world to require employers to provide retirement savings plans. Where there is cultural sensitivity to mandating compliance, moving to automatic enrolment with an "opt-out" option as opposed to an "opt-in" approach has proven to be quite effective as well.

Research shows a discrepancy between the reasons individuals give for not participating in savings plans and what their employers think are the reasons. The business leaders believe that employees are not participating in savings plans due to the lack of awareness or visibility of the plan, while individuals claim it is due to affordability.[4]

- **Encourage participation:** Allowing employers to contribute independently, or to match employees' contributions, has been shown to encourage participation and will improve adequacy. When businesses contribute to retirement plans, full-time employees are more than twice as likely to contribute themselves as opposed to employees in businesses that do not contribute.[5]

- **Find ways to include contingent and informal workers:** These types of workers are least likely to have access to a traditional workplace savings plan. And the group of workers with non-typical working patterns and non-traditional employers is growing. In addition, more workers are moving to and from informal/gig work throughout their careers, which disrupts regular saving habits.

Low-income populations

Low-income populations are focused on short-term expenditures and can experience significant income volatility, making it difficult to save regularly, especially for the long term. Research shows, however, that these groups do save, but in less conventional ways.

Considerations for low-income groups:

- **Encouraging long-term saving**, even if for small amounts. While purchasing annuities to provide a guaranteed lifetime income should be encouraged, it may not always make sense for those with very small fund balances. A modest account balance that may be too small to annuitize at retirement can still be used to delay drawing social security benefits by a number of years. This delay could materially increase retirement income for many people.

- **Encouraging emergency savings for the short and medium term** to help low-income groups avoid high fees on short-term credit for unforeseen emergencies or the need to use their retirement savings early.

- Bearing in mind that **a proportion of retirement security should be insurance/protection** for big impact events and a guaranteed basic standard of living (in places where it is not provided elsewhere by social protection systems).

- Where social security benefits are means tested against asset limits, examining the fact that **people saving for retirement may receive reduced social security benefits**, which can be a huge deterrent to saving.

Women

Women face a perfect storm of challenges when accumulating retirement savings. They earn less than men, contribute for fewer years, live longer and are more conservative in their asset allocation. In the European Union, the difference in retirement balances at retirement is estimated to be 37% lower for women on average, which is striking even versus a gender pay gap of 16%, based on the latest data collected from Eurostat, EU-SILC. Figure 3 shows the range of the gap across the 28 EU countries, with the bars representing the five largest countries by population (Germany, France, UK, Italy and Spain) as well as a breakdown of the effect of career breaks and lower returns due to asset allocation in contributing to the greater pension gap.

Women need more money for retirement. They live longer than men on average, hence spend more years of their lives in retirement, and so they must target a higher level of savings than men to achieve the same level of annual income throughout their retirement. In addition, women typically spend more on healthcare (approximately 7% a year in the United States) and are more likely to require professional caregivers.

Women face an unequal playing field. Because most people set savings aside during their working years, women are at a disadvantage as they participate in the workforce for fewer years than men on average. Women are more likely to leave the workforce to start a family or to care for sick relatives, for example. The gender pay gap, coupled with the type of jobs typically held by women, means their annual incomes are less than men's on average. A direct result is that women will save less during their working lives and will also receive lower matching contributions from employers (if they receive anything at all). Finally, research indicates that women tend to be more risk averse and are less confident about their financial security in retirement then men.[6] As a result, women are less likely to choose aggressive growth-targeted strategies and may miss out on opportunities for long-term growth of their retirement savings.

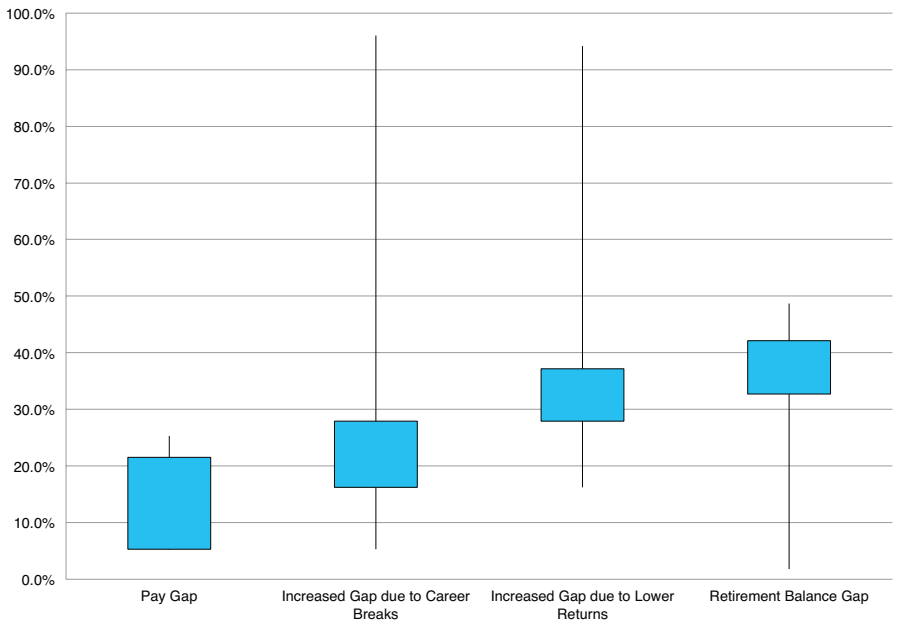
Actions to close the gender pension gap:

- **Recognize our differences:** Retirement planning will be different for women and men given the different life cycles. If women follow the same retirement plan as men, they will fall short in retirement. Retirement system providers should target women differently, giving them confidence to handle their finances and consider different investment strategies. Most importantly, employers must address the underlying pay gap, as that drives both lower savings amounts as well as lower accumulated pensions at retirement due to the power of compounding.

- **Acknowledge time spent out of traditional workplaces:** Governments and employers should consider ways to recognize the time individuals (both male and female) take out of the traditional workforce to contribute towards society (e.g. pension credits or increases in social security benefits) and remove any structural barriers to catching up on lost years of contributions (e.g. tax limitations).

Figure 3: Gender Pay Gap vs. Gender Pension Gap

Source: Eurostat, EU-SILC, 2016 data and World Economic Forum analysis



- **Be prepared for future disruption:** The Fourth Industrial Revolution is expected to disproportionately affect women. Governments and employers should understand how workforces are expected to evolve, and identify jobs at risk of technological disruption and any associated opportunities for reskilling and adjacent careers.

- **Encourage financial inclusion and independence:** Many women around the world rely on their husbands to handle the finances and provide retirement incomes. In many developing countries, the problem is more acute as many women do not have access to the financial system. Governments should ensure easy access to banking and savings products, perhaps using advances in technology (e.g. digital national IDs and mobile banking), to reach under-served pockets of society, including women.

B. Leverage technology to increase levels of savings

Digital transformation benefits

Technology can play a key role in expanding access and encouraging participation in retirement savings tools. Research shows that individuals are seeking secure, easy-to-use technology to help them manage their personal finances.[7] Older populations have the same desire for online tools, with 90% of adults under the age of 35 and 85% of all adults reporting they want digital help.

Four billion mobile phones are in use globally. Using a mobile phone to easily set up and contribute to savings vehicles has benefited individuals in developing economies such as Kenya. There, a bank-by-phone system is very popular, such that currently the majority of previously unbanked adults are able to save and transfer money using their mobile phone.

Spotlight on Mexico's digital transformation to expand access

Issue: A large number of Mexican workers are not engaged in retirement savings. Due to high levels of informal work, nearly 60% of the working population is excluded from the mandatory pension system. It is estimated that the old-age poverty rate in Mexico is above 30% and that only 29% of the elderly population (65 years and older) have a pension. For those who do participate, replacement rates (retirement income versus pre-retirement income) are very low due to low contribution rates and the time spent in the informal workforce. Half of the formal workers in Mexico have not even thought about their retirement income.[8]

Opportunity: Mobile phone usage has been identified as being more effective to increase participation in retirement savings than access to the internet or computers. In 2013, 99.9% of Mexicans had a mobile device, while, in 2015, fewer than 50% of households had access to a computer or the internet.

Progress: A number of initiatives over recent years have attempted to increase savings rates for Mexicans.

2015: Possibility to make voluntary contributions to existing Pension Fund Administrator accounts at common retail outlets, including 7-Eleven stores, as well as branches of a development bank and a state-owned telecommunications and financial services company

2016: Possibility to open a basic bank account through a mobile phone payment platform with only a mobile phone number, and to make deposits in a Pension Fund Administrator account by sending an SMS (short messaging service). No fees are charged and no smartphone is required.

Unique personal identification (ID): Digital IDs are an essential part of creating a financial inclusion ecosystem. Unique personal IDs enable individuals to more easily manage their savings and financial accounts, avoiding fragmentation, as well as lost monies and accounts. Providers are better able to target benefits (e.g. subsidies or credits) to the groups of society that need them the most. This element can be particularly important for informal economies with many low-income workers, those moving between the formal and informal sectors and those who take time out from the workforce (e.g. individuals with irregular work patterns and those taking time out to raise children or care for family members). In countries with well-established systems, introducing a unique identifier (e.g. a national ID number or biometric ID) can support the mobility of savings accounts across employers and geographies. Allowing savings from various sources to be consolidated significantly reduces the administration burden on both individuals and administrators to manage multiple savings accounts.

Spotlight on Biometric ID in India

A biometric ID has been introduced in India. For some individuals in the informal sector and those without jobs (e.g. female homemakers), this is their only form of ID. The national ID is paired with a pension system to expand access to workers in the informal sector by automating the creation of pension accounts.

This digital framework overcomes many of the barriers individuals face when trying to access a retirement savings system. Two of the system's key benefits are that no paperwork is required and individuals do not need to visit a physical bank branch to set up an account. In addition, contributions can be received from a variety of sources, including government incentives, micropayment plans and third parties.

Secure financial ecosystems: To embrace technology and innovation, safe digital financial systems must be created, which protect and engage individuals. Systems need to be safe and secure for individuals, protect consumers' privacy and be cost-effective and simple to implement. A regulatory oversight framework should be in place to address cyber-risk, ensure proper use of data and promote best practices.

Figure 4: Willingness of individuals to allow an online app to hold personal data to help manage their finances, by age group

Source: Mercer, "Healthy, Wealthy and Work-wise – The New Imperatives for Financial Security"

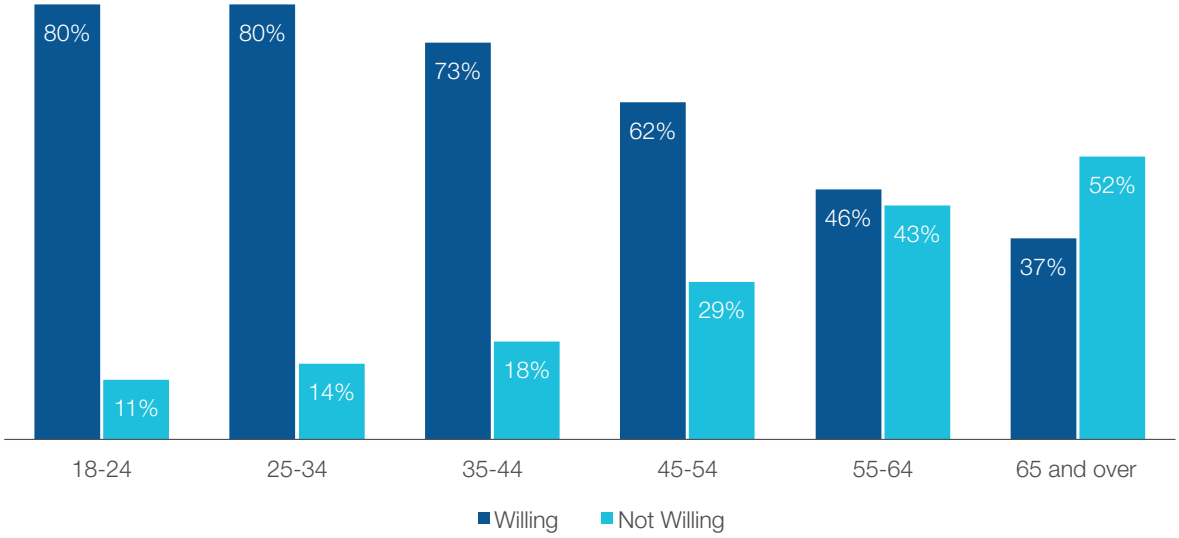
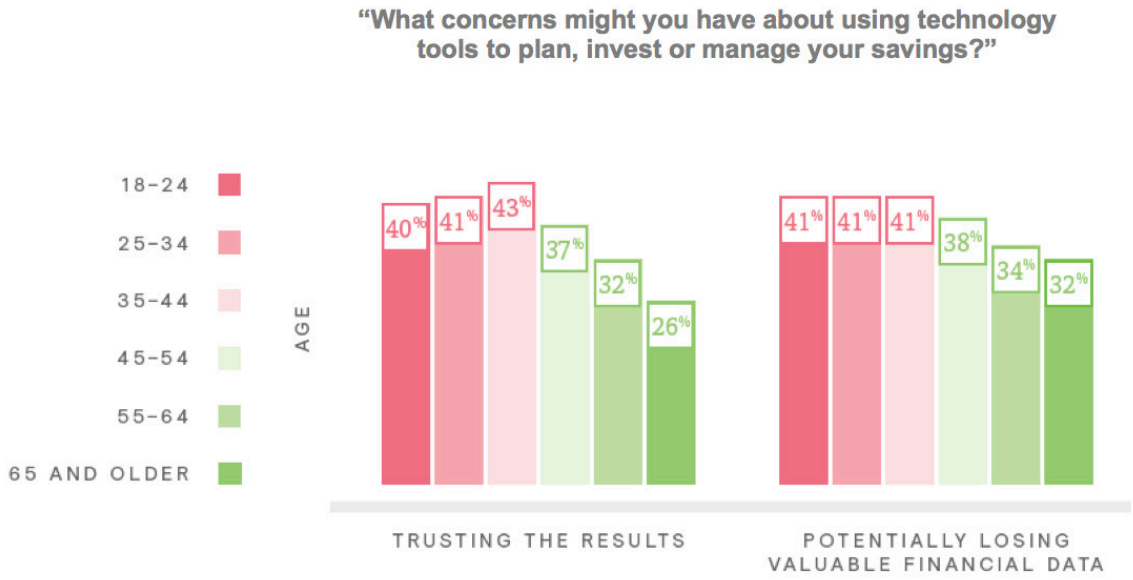


Figure 5: 93% of individuals aged under 35 are interested in online financial tools but they must be credible and secure

Source: Mercer, "Healthy, Wealthy and Work-wise – The New Imperatives for Financial Security"



C. Structure pension systems to provide incentive to improve participation

A number of tools are available to system providers and individuals to help close the savings gap. First, encouraging individuals to start participating in savings plans earlier is expected to have the most dramatic effect on closing the savings gap. Second, increasing levels of savings should significantly improve retirement outcomes. Third, discouraging or preventing individuals from drawing their savings early is also a key driver to improve retirement security.

Automatic design features to improve retirement outcomes

Using automatic features can significantly increase individuals' retirement income; many retirement systems around the world have successfully adopted this approach. Automating the enrolment process by opting participants into a plan by default, but allowing them to opt out if they do not want to participate, can lead to participation rates in excess of 90%. Auto-enrolment simplifies the participation process for individuals by reducing the required paperwork and the number of decisions to be made.

Retirement outcomes can be further improved by adding techniques to automatically re-enrol participants who previously opted out, and by automatically increasing contributions at an agreed-upon rate.

Considerations for automatic enrolment:

- Auto-enrolment has proved successful in increasing participations rates, but the approach relies upon an individual's inertia. This comes with the risk that participants are not engaged in retirement planning and will be less likely to take the time to understand and appreciate the benefits they are entitled to, potentially leading to poor decisions down the line.

- Plan providers must ensure individuals are not given a false sense of security when they are automatically enrolled in a retirement savings plan. Individuals need to understand that they may need to contribute additional savings, in addition to the default contribution rate, to meet their expectations for retirement income.

- Automatic techniques have the most impact when individuals are engaged and understand the need to save. Pairing auto-enrolment techniques with financial education will help individuals make better decisions and start saving earlier and at higher contribution rates, with reduced plan leakage.

- Attention should be paid to the source of the additional savings; auto-enrolment is effective when additional savings come from reduced consumption and are not funded by an increase in consumer debt.

Impact of enrolling individuals automatically

Plan providers can adopt automatic enrolment to simply enrol employees into plans. This tactic avoids burdensome paperwork and individuals making proactive financial decisions. While some systems are mandatory, many pair auto-enrolment with an opt-out feature to ensure the individual retains the choice to participate. **Adopting automatic enrolment is estimated to increase retirement income by 33% when compared to voluntary enrolment**, assuming individuals reduce consumption to fund contributions to a retirement savings plan.

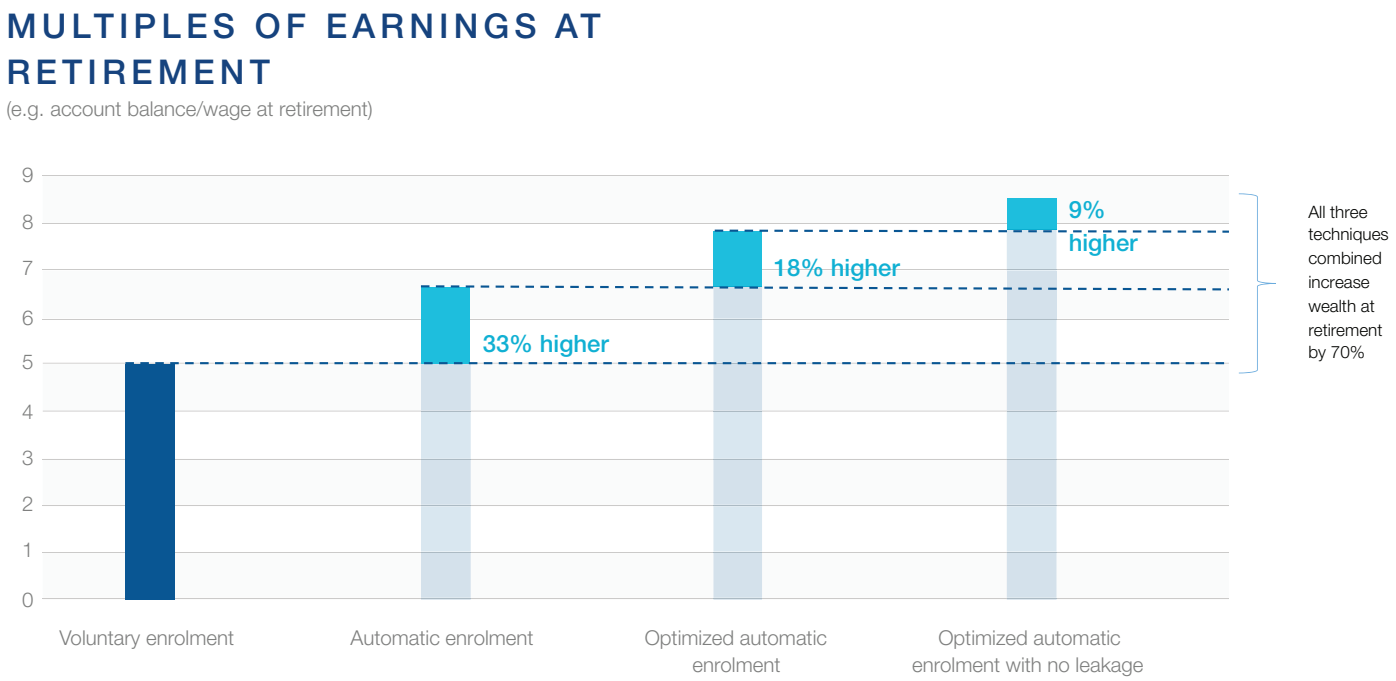
Impact of increasing contributions automatically

Taking this a step further, systems can build in automatic increases that gradually raise savings levels ("optimized automatic enrolment"). This increase could be a percentage pre-programmed to increase after a certain number of years or perhaps tied to life events or promotions and pay increases.

Behavioural economics studies show that individuals often make poor decisions when the outcome has an immediate effect on their lives, for example what to eat for lunch, whether to exercise and, more importantly, how much to save today. However, some studies show that people are better at making sensible decisions for future events, largely because those decisions do not have an immediate effect.

Figure 6: Wealth at retirement can be 70% higher when using automatic techniques coupled with leakage prevention

Source: Employee Benefit Research Institute (EBRI) analysis, Retirement Security Projection Model®[9]



For example, certain people may be unwilling to increase their current contribution rate to a savings plan today, but they may be willing to agree to an increase that occurs in the future (e.g. to coincide with future pay increases). Retirement systems can pre-programme an individual's retirement plan to increase savings over time (e.g. auto-escalation). **When contributions are automatically increased from 6% to 10%, an individual's wealth at retirement could be 18% greater**, assuming individuals reduce consumption to fund increased contributions.

Impact of preventing individuals from accessing their retirement savings early

Once savings begin to accumulate, the next challenge for individuals is to refrain from dipping into their retirement savings. Unfortunately, many savings intended for retirement do not last until retirement; sometimes they are drawn for medical emergencies or critical housing repairs, or during periods of unemployment. **Preventing individuals from accessing their funds prior to retirement can improve outcomes a further 9%.** However, some individuals will be dissuaded from participating in long-term savings plans if they cannot access their funds early. Considering emergency savings accounts, for example, could help address this issue.

Combining these three techniques – auto-enrolment, auto-escalation and preventing leakage – is expected to increase wealth at retirement by 70%.

Impact of saving earlier

A key challenge is that many people delay retirement savings until they are in their 40s or 50s. Although saving early in one's career, when the earning potential is lower and projected expenditures are higher, is inherently difficult, the idea of starting early to build the "savings habit" is important even if it is at a lower savings rate initially. It is not that people are deliberately delaying retirement planning but that, at each life stage, more immediate financial considerations come first.

At this point, retirement may be 10-20 years away. Typically, in developed countries, many workers in their 20s will be directing available monies towards other priorities, such as paying off student debt or saving for a deposit to buy a home. In their 30s, priorities shift towards starting families or paying a mortgage, and retirement feels like a long way off.

Investing money earlier provides opportunities to benefit from the fact that investment returns are reinvested and have the potential to also earn investment returns, which can significantly improve retirement outcomes.

Figure 7: Wealth at retirement can be significantly lower when savings are delayed by just five years

Source: Authors, based on Employee Benefit Research Institute and Mercer analyses

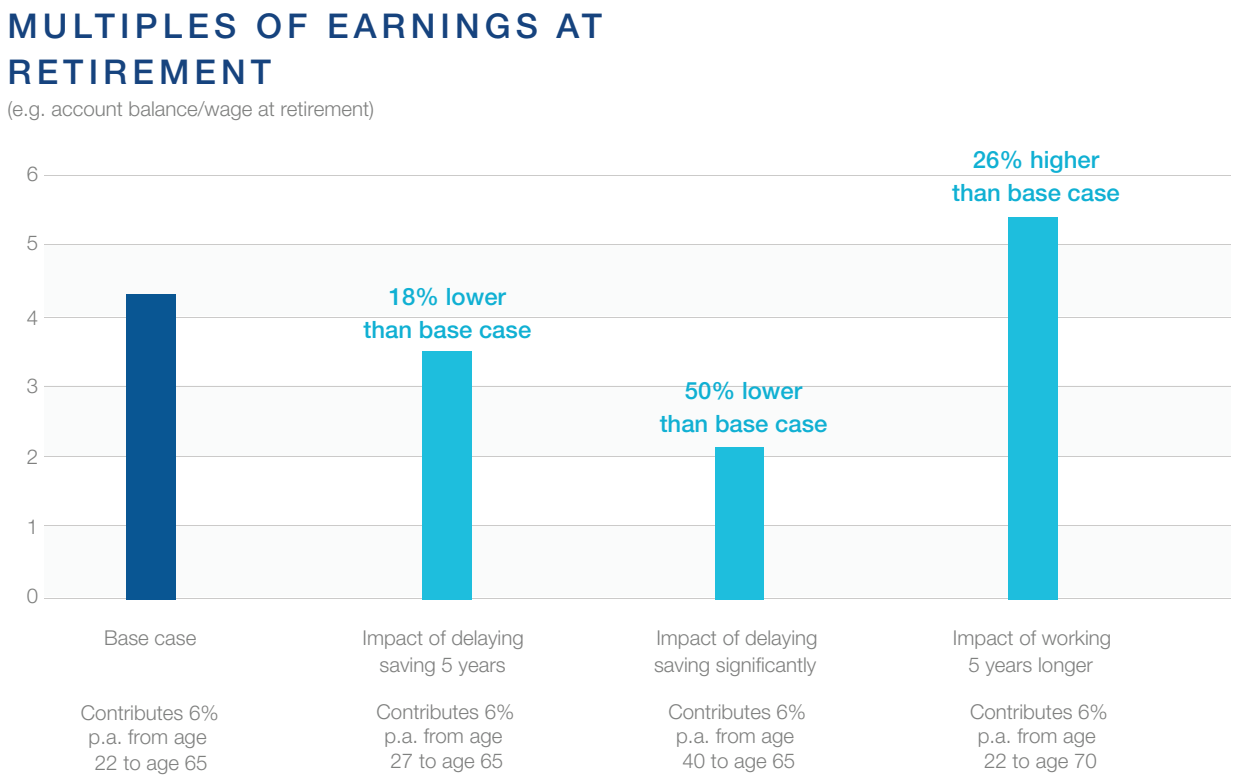
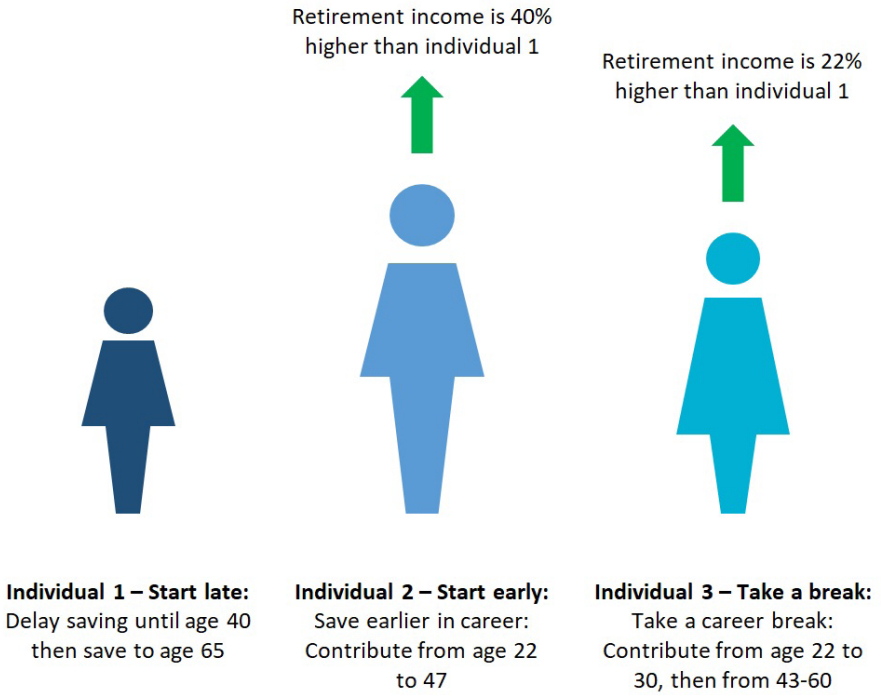


Figure 8: Wealth at retirement can be significantly higher when savings start earlier in life

Source: Authors, based on Employee Benefit Research Institute and Mercer analyses



The analysis using the Employee Benefit Research Institute's Retirement Security Projection Model shows that delaying retirement savings just five years, at age 27 instead of 22, results in a retirement account 18% smaller. If retirement savings is delayed until age 40, the balance is half the size. On the flip side, delaying retirement until age 70 instead of 65 and continuing to contribute results in an account balance that is 26% larger at retirement.

Impact of saving at different times in life

Comparing three individuals who each contribute for 25 years but who save at different periods of their lives shows that the retirement outcomes depend significantly on the ages at which they contribute. This differential is due to both the length of time contributions are invested and the difference in the size of contributions made (a function of salary).

This analysis shows that retirement outcomes are significantly better for individuals who start saving earlier, even with significant breaks in contributions or the individual stops contributing at an earlier age. This analysis is not intended to promote interruptions to contribution payments or recommend ceasing to contribute earlier in life, but to demonstrate the benefits of compound interest on savings made earlier in an individual's lifetime.

The need for emergency cash

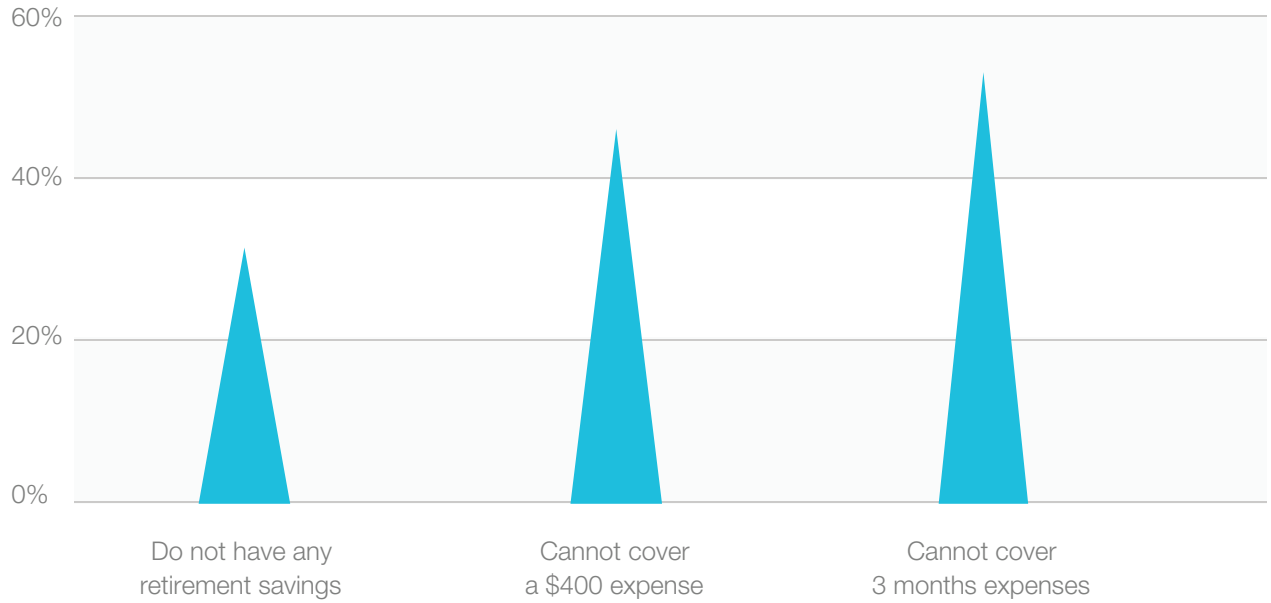
During the accumulation phase, retirement funds can be lost when individuals access their savings early. Unforeseen events, such as job losses or medical expenses, result in early withdrawals from retirement accounts in the United States. Approximately half of funds invested by those under the age of 55 are leaked out and are not repaid.[12]

Some individuals are reluctant to set money aside for their retirement if they cannot use that money for emergencies. Many Americans have inadequate access to emergency funds. Almost half (46%) of individuals would not be able to pay a $400 expense without selling something or borrowing money. Half of Americans find it difficult to pay monthly bills and less than 50% have set aside emergency or rainy day funds to cover expenses for three months, in case of sickness, job loss, economic downturn or other emergencies.[13]

Access is not just a problem for low-income workers; many medium-to-high income earners have poor budgeting skills and consume all they earn each month. This behaviour can be witnessed across income and age spectrums.

Figure 9: American's financial capability

Source: Based on Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2015,* 2015 National Financial Capability Study



One solution is to encourage individuals to set aside emergency savings, separate from retirement savings, for hardship and medical circumstances. Separation from retirement savings is crucial, given the concept of mental accounting (see "Spotlight on financial mental accounting"). Research shows people are less likely to withdraw funds if separated into different accounts, and are also less likely to overspend on emergencies.

In addition, carefully applying penalties on withdrawals that are not paid back or making withdrawals conditional on certain situations can deter individuals from dipping into their retirement savings accounts.

Many retirement systems allow individuals to take some or all of their retirement savings as a lump sum. A balance needs to be found between giving individuals freedom to use their funds as they need, and helping them to make their savings last throughout their retirement. Governments can limit the amount taken as a lump sum. This restriction has been implemented in Singapore, where individuals can only take a lump sum if the remainder of their savings can provide a certain level of lifetime income.

Spotlight on financial mental accounting

Soman and Cheema (2011)[14]

A group of low-income manual workers in India were involved in a study on the concept of mental accounting. The study analysed the impact of imposing savings targets and partitioning savings.

Each week, the workers were given cash savings from their wages in envelopes. The group of employees was split into four sample groups and savings were recorded over a 14-week period.

Half of the group was given a low savings target (40 rupees a week) and half a high savings target (80 rupees a week), representing 6% and 12% of their weekly income, respectively. These levels of savings were significantly higher than the workers' current levels of saving. Each of these groups was then split into two groups to reflect different delivery models. One group received cash savings in one envelope and the rest received savings split equally into two envelopes.

	Low savings target 40 rupees	High savings target 80 rupees
Cash savings delivered in one envelope	40	80
Cash savings delivered in two envelopes	20 20	40 40

Results: Partitioning savings had a significantly positive impact on the level of savings:

Total savings (rupees):

	Low savings target 40 rupees	High savings target 80 rupees
Total savings when cash delivered in one envelope	269	211
Total savings when cash delivered in two envelopes	373	456

When individuals mentally separate money, it affects their financial decision-making. Those receiving their savings in two envelopes were more conscious of their saving targets and better resisted the temptation to spend their savings, especially the savings in the second envelope. As a result, those whose savings were separated into two envelopes were less likely to spend the savings from their second envelope and saved significantly more than those receiving savings in one envelope.

This suggests that the concept of mental accounting has some influence on how likely people are to spend their savings and how much of their savings they will spend. Separating savings for the short term (e.g. emergencies and unexpected life events, such as home/motor repairs, medical bills or temporary unemployment) from longer-term savings can help individuals to budget and to avoid overspending when dipping into their savings.

Recommendations for policy-makers and system providers across the globe

Closing the pension savings gap requires cooperation from governments, employers and individuals. While efforts are being made around the globe to improve retirement systems, lessons can be learned from others' experiences as action is taken to reshape the future of long-term savings.

- **Make systems inclusive:** The pillars of a pension system should be coordinated holistically to meet the needs of all individuals and provide support for marginalized groups.

- **Create a harmonized framework of regulation and political accountability:** Many countries' retirement systems are organized in a multi-pillar framework, usually resulting in the involvement of many different ministries, government agencies and other organizations. Responsibility is typically split across government departments, and often a holistic vision is lacking. Governments must take responsibility to understand their population's retirement savings needs, ensure retirement systems have clearly stated objectives or goals, and measure and monitor the metrics on a regular basis.

- **Design plans that are easy to implement and low cost:** Systems should be simple and cheap for governments and employers (especially small businesses) to implement, and low-cost plans should be designed with frictionless processes for employers and employees.

- **Invest in digital transformation:** Governments should invest in digital transformation to provide an infrastructure that is accessible and affordable to promote digital financial services among underserved populations.

- **Ensure portability:** Accounts should be portable across employers/regions where possible; portability is particularly important in developing countries with large informal labour markets.

- **Increase savings levels and reduce leakage for emergencies:** Access to separate emergency savings can encourage participation and help to manage leakage from retirement savings accounts. It should be made easy for private-sector organizations to create plans, particularly those allowing employers to match employees' contributions (or at least contribute).

- **Increase participation:** Encouraging auto-enrolment and providing incentives for individuals and employers will increase participation.

- **Educate and reach out:** Educating individuals about the programme will encourage participation and build confidence in the system. Also connecting with and educating employers will help secure their engagement in the programme, especially in the rollout phase.

- **Guarantee participant protection:** It is important to ensure providers and products meet a set of standards before allowing them entry into the market.

- **Close inequality gaps:** The focus should be on increasing contribution density, not just on contribution rates. System providers should allow those who have had gaps in contributions to make catch-up contributions, and reduce or eliminate vesting periods, the waiting periods during which they are employed but not yet allowed to join the employer's pension plan, to allow participants to contribute sooner. Governments can offer pension credits or income replacement payments for those with periods out of the workforce (caregivers, the disabled, parents raising children, individuals who experienced periods of sickness or unemployment, etc.).

Case study: US retirement system – current situation, challenges and recommendations

Retirement systems face a host of challenges globally, including in the United States, where the retirement savings gap is the largest in the world. The gap was estimated at approximately $28 trillion in 2015[15] across the three pillars (public pensions, occupational pensions and individual savings) and it is expected to widen to about $137 trillion by 2050,[16] largely as a result of the effects of improvements in life expectancies. Given the significance of the United States in terms of size of the global savings gap, this case study focuses on the challenges and suggests recommendations for policy-makers.

Research suggests that many Americans are not prepared for retirement; an estimated 90% do not have enough saved for retirement. In particular, roughly 30% of Americans have not even begun saving for retirement.[17]

Key drivers of the savings gap in the United States:

1. **Policy changes at the federal level**: Past administrations have attempted to reform the retirement system but have largely been unsuccessful.

2. **Occupational plans**: Nearly half of American private-sector workers (around 55 million people) do not have access to an employer-facilitated plan.[18]
   - In the United States, employers are not currently required to offer a retirement savings plan.
   - Many medium-to-large businesses are closing their occupational DB plans due to large deficits and high running costs. Employers are switching to DC plans where risk is shifted onto the individual and, typically, employer contributions are lower.
   - Research shows that small businesses are less likely to offer a retirement savings plan. The expense, fiduciary liability and resource intensity of establishing and maintaining retirement plans are key factors in smaller employers' decisions to not offer retirement plans.

3. **Individual savings**: Many Americans are not saving enough.
   - While voluntary savings vehicles, such as individual retirement accounts (IRAs), can help workers accumulate savings, research shows that they are not being used; less than 10% of workers regularly contribute to an IRA.[19]
   - Even when individuals do accumulate retirement savings, the leakage out of savings vehicles is substantial. For each $1 saved for retirement, roughly 40 cents is leaked out through early access.[20] Two factors contribute to individuals accessing their retirement savings early. First, many plans allow people to withdraw funds prior to retirement with no requirement to pay the funds back later. Second, individuals are not deterred by the plans that may impose a penalty on early withdrawal, choosing to use their retirement funds for other purposes prior to retirement.

In response to this challenge, several US states are reforming their retirement systems. Their focus has been on expanding coverage, particularly for private-sector workers in small businesses. Across the United States, these states are experimenting with various models to increase access to retirement savings vehicles, with the goal of increasing the level of retirement savings and thus improve retirement security.

Some states are designing or implementing models designed to provide workers in the private sector with access to retirement plans (e.g. mandated payroll deduction IRA programmes for employers who do not currently offer a retirement savings plan). Others are using web portals, and at least one state is launching a Multiple Employer Plan (a single plan adopted by two or more unrelated employers).

Challenges in the United States to expand access to retirement systems

Individual states may face certain key challenges when passing and implementing retirement system reforms to expand access in the private sector:

Figure 10: State initiatives, 2018

Source: Georgetown University Center for Retirement Initiatives, "State Initiatives 2018: New Programs Begin Implementation While Others Consider Action" (https://cri.georgetown.edu/states/)

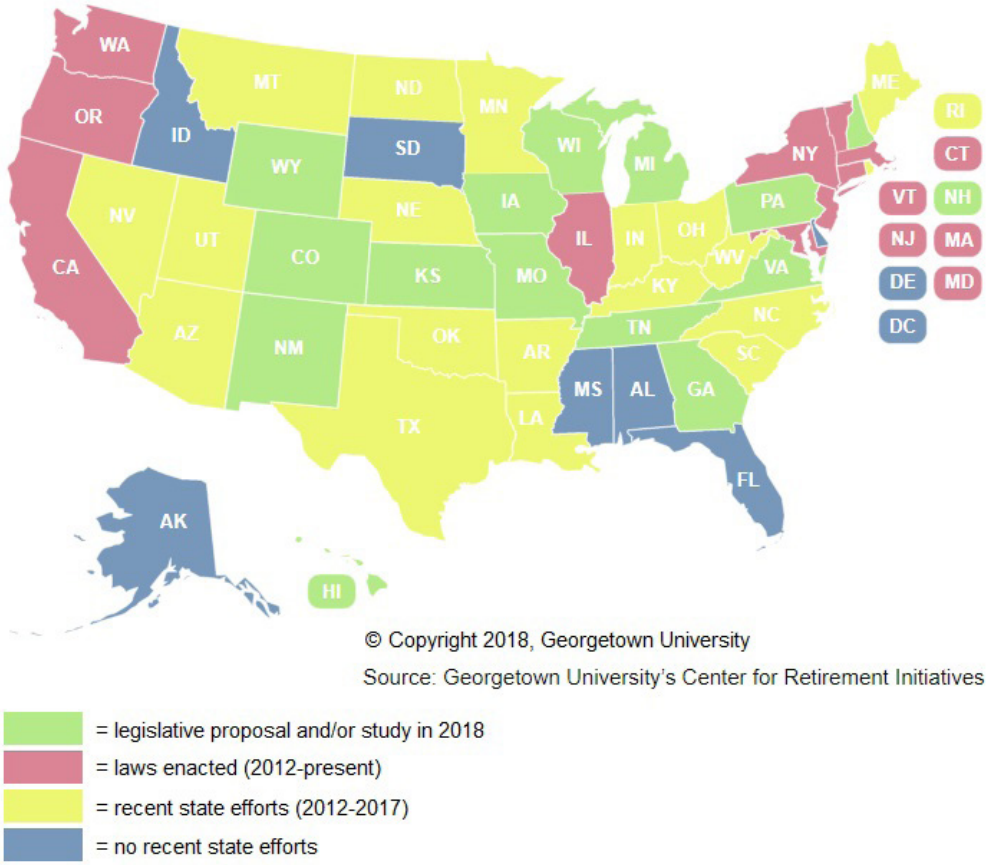


Figure 11: Challenges to retirement system reform in the United States

Source: Authors

A. Access

In the US, employers are not currently required to offer a retirement savings plan.

B. Participation

There is a lack of clarity on the ability of states to require auto-enrolment and to make employer participation mandatory.

Opportunities to provide incentives to employers and employees are scarce.

C. Adequate Savings

Only one-third of Americans have saved enough for retirement. [21]

Improved low-cost and simple tools are needed to ensure a secure retirement income.

D. Efficient Asset Decumulation

Problems exist with regard to fund leakage during the accumulation phase and how to optimally use funds during retirement.

E. Implementation

There are issues regarding how to move accounts between employers and how to ensure that the different types of accounts can be combined safely and easily.

What the United States can learn from other countries

The World Economic Forum worked with representatives from four national pension systems to capture some of the lessons from their experience:

Australia's Superannuation System: The Australian Superannuation System is renowned for successfully increasing coverage and levels of savings, but the system is dealing with certain major challenges that provide interesting considerations for those designing new systems. Employers are mandated to contribute 9.5% (to be increased to 12% by 2025) and employees can make voluntary contributions in addition to those made by the employer. Individuals choose the plan provider.

Canada's Pooled Registered Pension Plans: Pooled Registered Pension Plans (PRPPs), recently introduced to address the workplace savings gap in Canada, aim to provide a simple, low-cost, large-scale portable system. The system is voluntary for employees, employers and the self-employed. Employers choose the plan provider.

New Zealand's KiwiSaver: KiwiSaver was introduced 10 years ago to increase occupational retirement savings levels. Employers and employees must each contribute at least 3% via auto-enrolment mechanisms with opt-out features. Individuals choose the plan provider.

The United Kingdom's automatic enrolment in workplace pensions: The United Kingdom is five years into a programme to roll out workplace pensions throughout the private sector. Employers and employees must each contribute 5% and 3%, respectively (by 2019), using auto-enrolment mechanisms with opt-out features. Employers choose the plan provider.

Findings from Australia's Superannuation System:

- **Portability:** There is no unique national ID number in Australia, which poses challenges for account portability. Individuals can accumulate many different savings pots throughout their careers as they change employers. Retirement systems that allow portability and account consolidation significantly reduce the number of accounts as well as the administration burden on individuals, providers and regulators.
- **Market size:** The competitive market for providers is large, offering 42,000 different investment options for a working population of around 12 million. While it provides individuals with extensive choice, this system has created challenges for regulators regarding the scale of products to oversee. Challenges in disclosure arise when products are disparate, because of their complexity and legal structure. This can lead to efforts to simplify messaging through straightforward disclosure mechanisms (e.g. product dashboards).
- **Market oversight:** The Australian Prudential Regulation Authority's role is to approve MySuper products, simple and low-cost superannuation funds, against minimum criteria, but the criteria may not guarantee against poor quality. This creates the risk that all products are perceived as being of good quality and fit for purpose because they are authorized by the government, shifting the burden of promoting quality to the government and away from the provider.

Findings from Canada's PRPP experience:

- **Portability:** The PRPP framework largely applies to all employees across seven of the 10 provinces and the federal jurisdiction (which account for over 84% of Canada's population). Accounts are portable throughout those provinces and federal jurisdiction, and benefit from economies of scale.
- **Implementation:** This harmonized approach was achieved through high political engagement at both the provincial and federal levels, with representatives meeting every two weeks throughout the system design phase. This collaboration helped all participating jurisdictions to agree to a common set of rules and a majority of uniform design features.
- **Oversight:** Plan supervision is executed at the federal level, with the exception of one province, to reduce filing requirements.

Findings from New Zealand's KiwiSaver experience:

- **Market oversight:** Providers must be accredited with the government, meeting particular rules prior to entering the market. A saver can only have one KiwiSaver account but may transfer to another provider if wanted. Individuals who do not select one are enrolled into nine default providers on a rotating carousel basis.
- **Implementation:** The New Zealand tax office acts as the central administrator, collecting money through the PAYE (Pay as You Earn) monthly return from employers and passing the money on to the relevant plan provider.
- **Incentives:** Government incentives to encourage participation worked well; the government incentivized participation through a "kick-start" lump sum and a matching contribution to individuals in the form of a tax credit. Initially, the sum was NZ$1,000 on joining a scheme, and an additional NZ$1,000 per year if the individual contribution reached at least NZ$1,000 in that year. This incentive was decreased to NZ$500 per year to individuals who paid in NZ$1,000, but the kick-start was eventually abolished. In the first couple of years, employers were also incentivized through an employers' tax credit, which offset the contributions they made for their employees. These incentives played an important role in the programme's success.
- **Access and early savings:** A unique feature of this system is that adults can open accounts for children.

This aspect has proved extremely popular. Approximately one-third of the population under the age of 18 has an account; the government's NZ$1,000 kick-start contribution was also available to them.

Findings from the UK's automatic enrolment experience:

- **Participation:** Participation rates are very high, largely driven by a combination of auto-enrolment (all staff must be enrolled in a plan and need to opt out if they do not wish to participate) and automatic re-enrolment every three years of workers who previously opted out.
- **Incentives:** Both employers and the government contribute to individuals' funds; individuals receive a 1% contribution from the government in the form of tax relief.
- **Market providers:** The NEST (National Employee Savings Trust) was established with a Public Service Obligation; the trust is required to allow any employer to set up a plan. This requirement mitigates the risk of providers turning employers away, causing them to be non-compliant.
- **Market oversight:** Non-compliant employers are fined a £400 fixed penalty, plus an additional £50 to £10,000 escalating fine per day, which is set depending on the size of the workforce.
- **Implementation:** The regulator successfully engaged employers during the rollout phase, nudging them along gradually month after month and providing them with information at each stage. TV and radio campaigns proved most effective to raise the awareness of employers and employees.
- **Implementation and oversight:** Payroll systems play a large role, through automation, in ensuring employers are compliant.

Policy proposals at the federal level to expand access in the US private sector:

- **Expand access:** Encourage retirement plans for more Americans, facilitated through the workplace
- **Design specific systems:** Ensure legislation captures the overarching objectives but allows individual states the flexibility to design systems that meet their specific needs; clarify the legal status of requiring auto-enrolment through employers and provide flexibility under the Employee Retirement Income Security Act
- **Increase savings levels**: Find ways for employers to contribute and increase annual IRA contribution limits
- **Increase participation:** Encourage auto-enrolment and provide incentives for individuals and employers
- **Ensure portability:** Make it easier for accounts to be portable across employers and states where possible
- **Maintain simplicity:** Design low-cost plans with frictionless processes for employers and employees
- **Educate and reach out:** Educate individuals about the programme to encourage participation and build confidence in the system; connect with and educate employers to ensure they are engaged in the programme, especially in the rollout phase

Acknowledgements

To focus on this critical and challenging topic, the World Economic Forum brought together multiple stakeholders, including national, state and local governments, regulators, private and institutional investors, asset managers and insurance companies, drawing on solutions and experiences from various regions and countries, to implement the Retirement Investment Systems Reform project in collaboration with Mercer.

The objective is to raise awareness of the implications of the market shift and look for opportunities to drive pension policy reforms. Best practices are also identified, and draft recommendations aim to ensure: 1) access by individuals to retirement solutions; 2) the sustainability of retirement systems; and 3) access by businesses and infrastructure to long-term capital.

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