



ISSA World Social Security Forum 2013  
*Proactive and preventive approaches across all risks:  
Supporting sustainability*

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[www.issa.int/wssf2013](http://www.issa.int/wssf2013)

## Proactive and preventive approaches across all risks: Supporting sustainability

### ■ Financial Sustainability

- Asset and Liability Management (ALM) of pension schemes as a proactive and preventive tool (a joint project of the TC ACT and the TC INVEST)
  - Addressed at the International Seminar in Abu Dhabi in March 2012 and at the Technical Seminar in Muscat in February 2013
  
- Sustainability of health care financing (a joint project of the TC ACT and the TC MCSI)
  - Addressed at the 17<sup>th</sup> International Conference of Social Security Actuaries and Statisticians in Berlin in May 2012 and the Technical Seminar in Muscat in February 2013





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## Proactive and preventive approaches across all risks: Supporting sustainability



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Q A T A R 2 0 1 3

- Intergenerational Sustainability (encompassing both financial and political sustainability)
  - Promoting a fair intergenerational balance (a joint project of the TC ACT and the TC IVS)
    - Country case studies prepared by Canada, Denmark, France, Saudi Arabia and Uruguay, and by IAA for Japan
    - Presented at the Technical Seminar in Muscat in February 2013
    - Summary report is posted on TC ACT web page



## **ALM for social security scheme is aimed at ensuring its sustainability by coordinating assets and liabilities**

- **ALM objectives often are setting investment policy and/or balancing risks and rewards**
- **Risks include market, liquidity, credit, and demographic risks**
  - Demographic risks are specific to social security systems
- **ALM may be based on stochastic simulations and/or scenario testing**



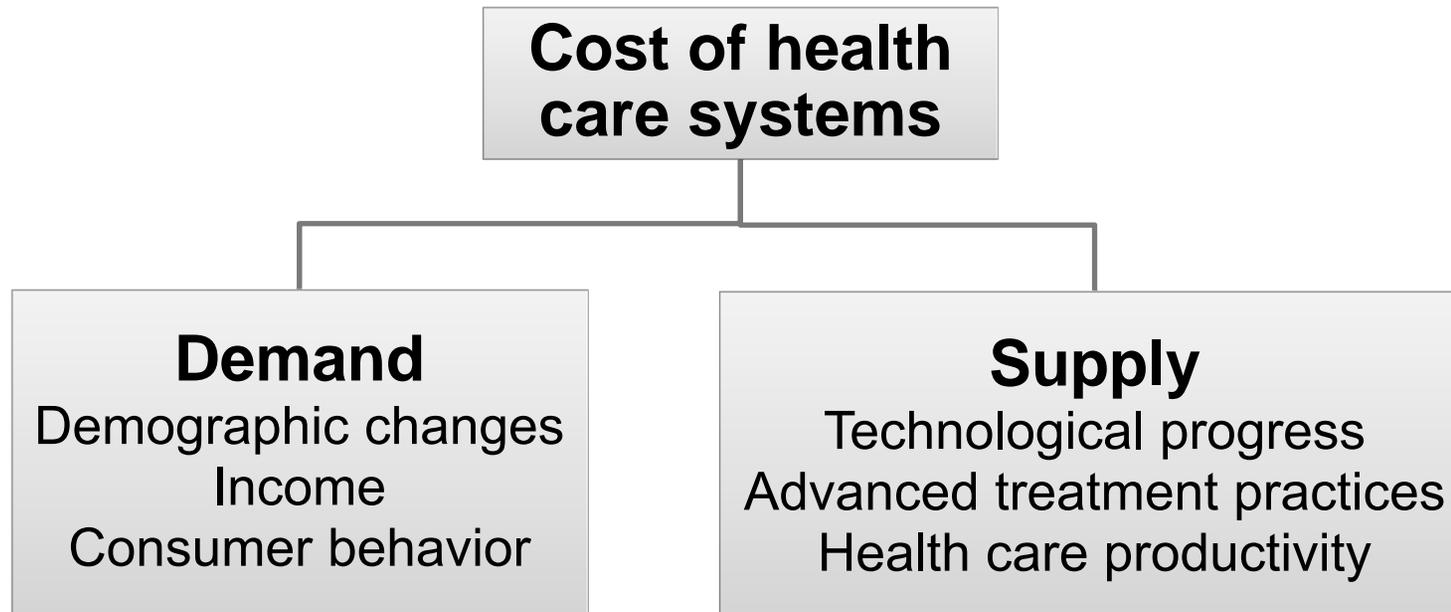
## **ALM is a key element of any proactive and preventive strategy as it promotes early intervention and risks reduction**

- **ALM could be used for systems with different degree of prefunding**
  - Need clear understanding of liabilities involved
- **Proper communication and interpretation of results is important**
  - Results are translated into decisions affecting well-being of wide segments of population
- **Proper governance framework in which ALM operates is of the utmost importance!**

“After the financial crisis, ALM is not an optional function. All social security institutions irrespective of size need to develop an ALM.”

Oman, PASI

# Health care expenditures are highly uncertain



Medical expenditures increase with age: Populations which are currently young or middle-aged are also aging!



## Health spending has a potential to become one of the major drivers of economic growth

- In order to be sustainable, a health care system should be based on solidarity
  - It should cover a wide segment of population to allow for risk pooling
  
- Health care sustainability aspects
  - **Fiscal:** current problem faced by many countries
    - it needs to be restored in the short term
  
  - **Economical:** long-term challenge which requires policies that ensure value for money





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## Intergenerational equity: A condition for sustainable social security



- **Pension systems tie generations together by a social contract**
  - The intergenerational contract needs to be equitable in order to be sustainable
  
- **Aging of the population, increasing longevity, falling fertility rates shift “equity balance” in favor of the old**
  - Increasing duration of pension payouts and of pension promise value
  
- **Pension costs could put a substantial strain on public finances**
  - The welfare development potentials for younger generations could become limited



## Definitions of the intergenerational sustainability and equity vary by country, system design, financing approach

- **How to define intergenerational equity?**
  - Same contribution rate or same benefits?
  - Retirement at the same age, pensions paid over the same number of years?
  - Stable poverty rates of elderly over time?
  
- **Objectives of a system may presume a degree of intended intergenerational transfer**
  - First pillar pensions aimed at poverty reduction are based on principles of intra- and intergenerational solidarity
  - The intergenerational fairness is violated when intergenerational transfer becomes unintended



## Different measures address different aspects of the intergenerational equity puzzle

### Sample measures for the second pillar

- Ratio of present value of benefits to present value of contributions over the life-time (France, Japan)
- Ratio of present value of total contributions to annual value of the pension (France)
- Internal rate of return (IRR) - the rate which balances out the present value of total contributions and the present value of total benefits (France, Canada, and Uruguay)
- Stability and affordability of the contribution rate for future generations (Canada and Japan)
- Full solvency (Denmark)



## Country reports highlighted possible policies aimed at preserving intergenerational equity

- **Diversification - addition of different financing approaches and system designs**
  - Multi pillar structure with different financing allows to
    - Diversify risks

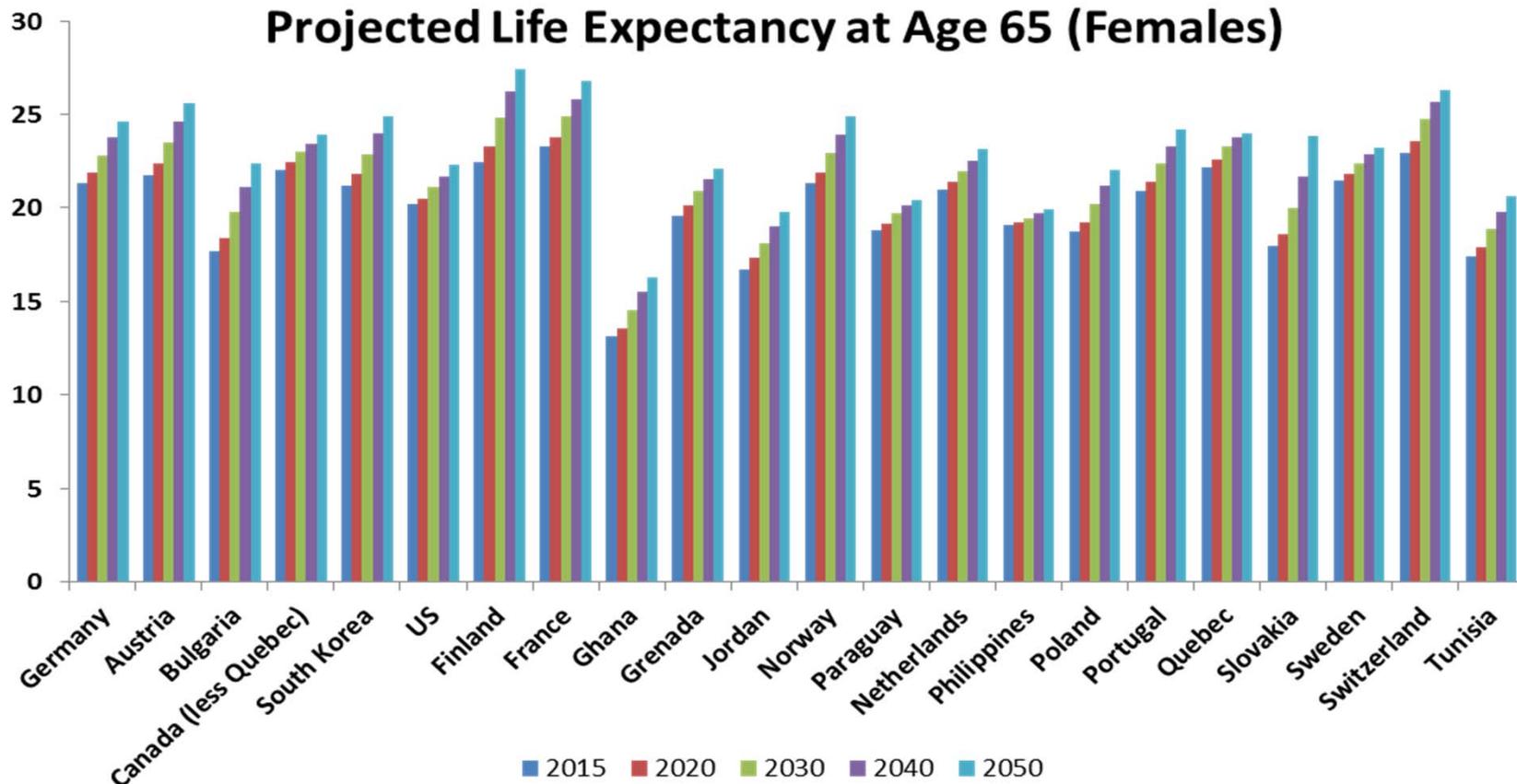
Canadian retirement income system is based on a diversified approach to savings and has capacity to adapt rapidly to changing conditions

- Divide pension responsibilities between state, employer/employees and individual households
- Continue to provide social protection to most vulnerable seniors

Uruguay restructured its first pillar system instead of removing it as it was done by many South American countries



# People live longer. Should they work longer?



Source: Survey "Comparison of demographic and economic assumptions in the actuarial analysis of 24 social security schemes" prepared and conducted by the Régie des rentes du Québec (Canada) in cooperation with TC ACT



## Early retirement programs are expensive

- **Limiting early retirement incentives**
  - Strengthen eligibility requirements for early retirement programs (Denmark)
    - Increase starting age
    - Increase length of required contribution period
  - Introduce higher early retirement penalties (Canada)
    - Flexibility of choosing when to retire remains

Early retirement provisions are identified as a major threat to the financial and intergenerational health of Saudi Arabian pension scheme



## How to increase effective retirement age?

- **Strengthen eligibility requirements for benefits**
  - Increase retirement age: a scheduled approach is used by many countries

Denmark indexes early retirement and pensionable ages to longevity

- **It should be to the advantage of participants to ask for their benefits at a later age**
  - Presently, many schemes do not provide sufficient incentives for postponed retirement (Uruguay, Saudi Arabia)
- **Increase labour force participation for older age groups**

France introduced an inter-generation contract aimed at linking the recruitment of a young person with the maintenance of a senior in exchange for a reduction in contributions for the enterprise.



## Financial and intergenerational sustainability of pension systems should be regularly monitored

- **The review of the financial status**
  - should be transparent
  - realistic assumptions should be used
  - results should be timely and clearly communicated to stakeholders.
  
- **Two international surveys lead by TC ACT provide tools for such reviews**
  - Survey on actuarial and financial reporting for social security schemes and its legal implications
  - Comparison of demographic and economic assumptions in the actuarial analysis of 24 social security schemes
  
- **Development of ISSA Actuarial Guidelines during the next triennium**



# Conclusions

- No matter if it is a fully funded or a pay-as-you-go plan, no matter if it is a DB or a DC solution, no matter if it is a national public scheme or a private pension plan, the fact is that increased longevity will continue to put pressure on the financing of pension plans
- Intergenerational equity and sustainability discussion cannot be limited to pension systems only

A framework leading to a more general concept of the intergenerational justice meaning that coexisting generations are all treated equally by a society should be considered

# Q & A

