

Australian School of Business

PBSS 2013 Colloquium

Never Stand Still

Australian School of Business

Risk and Actuarial Studies

Redistribution and capital market impacts: principles and scope for actuarial involvement

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Outline

- I Actuarial and social security retirement systems
- II Redistribution and justice
- III DB benefit ratios are opaque and can be manipulated
 - Longevity
 - Different rates of salary increase
 - Demographic change
- IV Communication and the public interest
- V Mandatory contributions distort investment markets
 - Financialisation
 - Demographic distortions
- VI Practical actuarial involvement in managing a Social Security System

Justice - governing power

Blindfolded - to
personal and
vested interests

Swathed
woman with
scale
emphasises
process

Sword
indicates
power to
exercise
discretion



"Justice is the bond of society
... the condition under which I
and every man can identify
with society, feel at one with it,
and accept its rulings as my
own." JR Lucas

In the scales:

- All the stakeholders
 - All groups of insured including pensioners
 - Taxpayers
 - Government
- Major criteria
 - Just deserts
 - Liberty (non domination)
 - Equality
 - Individual need
 - Efficiency

[See appendix A of Asher, A \(2010\)
"Innovation and Imperatives in
Financial Security Systems"](#)

Hard headed, but soft hearted?

“There is a regrettable tendency for equity arguments to be conducted within a rhetorical framework in which it appears possible to ‘do good’ at no opportunity cost whatever. It generates a great deal of righteous self-satisfaction for the romantic escapists and it puts economists back in the role of the dismal scientists always stressing the sacrifices, but it does not help the hard-pressed decision-makers who grapple with the issues in real-life every day. ... (we need) ... to bring home the fact that giving priority to one group inevitably disadvantages others, a consequence which many advocates of particular equity principles fail to make clear (and they rarely state who will be called upon to make what sort of sacrifice even when they do acknowledge this implication)”.

Williams, A. (1997) Intergenerational equity: an exploration of the 'fair innings' argument. *Health Economics*, 6(2), 117-132.

⁸ Speak out on behalf of the voiceless, and for the rights of all who are vulnerable.

⁹ Speak out in order to judge with righteousness and to defend the needy and the poor.

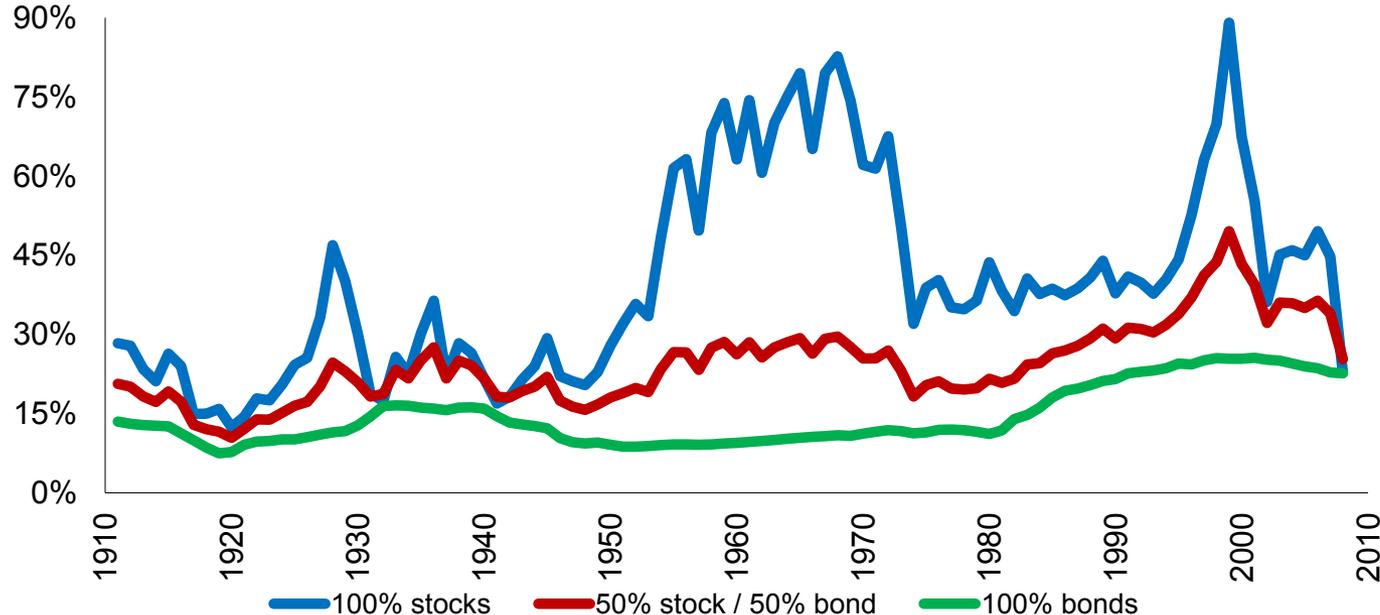
Proverbs 31:8-10 CEB

DB funds are opaque and open to manipulation

- Pensions for life subsidise the healthy and better off who live longer
- Final years salary formulae subsidise the better educated and senior staff whose salaries rise more steeply with age
- Poorly controlled public sector schemes subsidise the better paid particularly. Worldwide, public sector schemes are in significant deficit.
- More obvious “rorts”
 - Short averaging times (final day) are open to last minute promotions
 - Free back service
 - Can include everyone, but often unfunded
 - Can be limited to higher ranking new staff
 - Manipulating non-pensionable allowances (to reduce contributions and then increases pensions)
 - Poor withdrawal benefits create artificial surpluses then given to senior people

Equity risk

Replacement rate obtained from personal account savings of workers who invest in alternative portfolios



Stocks may always outperform bonds but there is a huge (5:1) difference between the best and worst outcomes

Source: Brown (2013) taken from Burtless (2009)

Discussion: professionalism and public interest

Communication winners and losers

- If actuaries do not do it, who can?
- Should actuaries do it?
- Is there a need for some protection or standard?

Communicating equity risk

- If actuaries do not do it, who can?
- Should actuaries do it?
- Is there a need for some protection or standard?

Mandatory funding ‘distorts’ investment markets

“Even though the gradual build up of pension savings in the USA, the United Kingdom, Canada, Australia, the Netherlands, Switzerland, and a handful of other countries has not resulted in the ‘socialisation of the economy’, as management guru Peter Drucker famously predicted in 1976, pension funds did come to dominate the world's asset markets, tempting some to speak of a veritable ‘pension fund revolution’ (Clowes, 2001).”

Engelen E, (2003) The logic of funding European pension restructuring and the dangers of financialisation. *Environment and Planning A* 35(8) 1357 – 1372

“And, indeed, there are good reasons for believing that the financial industry, more than any other sector of the economy, has an ability to generate unnecessary demand for its own services – that more trading and more financial innovation can under some circumstances create harmful volatility against which customers have to hedge, creating more demand for trading liquidity and innovative products; that parts of the financial services industry have a unique ability to attract to themselves unnecessarily high returns and create instability which harms the rest of society.”

Adair Turner (2009) Mansion house speech

Actuarial reports on SSRS

- The total liabilities of SSRS and the accrual over the past year – in total and by distinguishable groups of beneficiaries
- The assets available to pay the liabilities – including future contributions, government taxes – and the “returns” over the period
- The “emerging costs” showing the extent to which cash flows from the assets (including envisaged sales) will meet cash flows from the liabilities
- Changes to the assumptions and models – and the financial implications for future estimates
- Cross subsidies from one group to another with a particular focus on the labour market distortions created (such as restrictions on changing jobs and countries and early or late retirement.)

Impact of investment risks

These include those arising from equities, real investment property and inflation

It is of interest to government to know the extent to which random profits and losses from these sources have been born by identifiable groups in society

The response may be changes in the structure of social security or taxation

Reports to DC management

- Financial soundness and the management of risks
- An analysis of investment performance and expenses
- Whether discretionary allocations of expenses and benefits were appropriate
- Whether member products and services and particularly financial advice are appropriate

Further discussion

