Pension Notes

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2023 CFA Global Pension Index: the importance of individual savings and the impact of AI on pension systems

Federación Internacional de Administradoras de Fondos de Pensiones

Executive Summary

Mercer's 2023 Global Pension Index assesses the pension systems of 47 countries, with the Netherlands, Iceland and Denmark being the best rated, and India, the Philippines and Argentina, the worst.

Due to the effect of demographic pressures on the PAYGO systems, many governments of countries with these systems will have to face the challenge of reducing pension amounts or modifying key parameters, making it difficult to access a pension. Hence, the PAYGO systems have been increasingly complemented or replaced by individual savings mechanisms, especially in the countries best assessed by the index. The three best rated countries, the Netherlands, Iceland and Denmark, have individually funded savings of more than twice their GDP.

Among Latin America countries, Chile ranks 14th with 69.9 points out of a possible 100 (index value), Uruguay ranks 15th with 68.9 points, Colombia 24th with 61.9 points, Brazil 33rd with 55.7 points, Peru 34th with 55.5 points, Mexico 36th with 55.1 points, and Argentina last (47th) with 42.3 points.

It is worth mentioning that Chile's ranking rose from 16th to 14th due to improvements in the integrity sub-index (involving issues such as regulation, governance, protection and communication to members). Therefore, a substantial improvement in this country's ranking, due to an increase in the adequacy sub-index, is still pending. On the other hand, it can be seen that the multiple withdrawals of funds approved in Peru since 2016, and in 2020 and 2021, are beginning to affect its index value. The Mercer Report states that this reduction in index value is due to the drop in the level of assets reported by the OECD.

The 2023 Mercer Report's main suggestions to the countries of the region focus mainly on: increasing the minimum level of support for the poorest people; increasing the retirement age to reflect the increase in life expectancy and encouraging both mandatory and voluntary private savings.

The report also analyzes the impact that Artificial Intelligence (AI) could have on pension systems. Since AI gives Fund Managers the ability to analyze large amounts of data, it can help them identify a greater number of investment opportunities, resulting in higher long-term returns and lower volatility.

I. Introduction

Pension systems worldwide are under pressure as never before due to the change in demographic structure resulting from the drop in birth rates and the increase in life expectancy on retirement. These trends have major consequences for the PAYGO pension systems, which rely on the next generation of taxpayers to pay for the pensions of previous generations. Thus, in order to improve their sustainability, many governments of countries with PAYGO systems will have to face the issue of reducing pensions or modifying the key parameters of the system, making it difficult to access a pension.

One persistent problem is the inclusion in the pension systems of workers in non-traditional employment (gig economy) and those operating in the informal sector. In fact, the trend in many countries is towards a less structured relationship between employee and employer. This is another reason why pension systems will need to focus more on individual components and be less dependent on third parties.

The 2023 Mercer CFA Institute Global Pension Index has recently been published, and now includes the pension systems of three additional countries: Botswana, Croatia and Kazakhstan (a FIAP member country). Thus, this edition compares the pension systems of 47 countries, representing 64% of the world's population, with respect to their Adequacy (what benefits are likely to be received), Sustainability (the ability of the systems to continue paying benefits despite demographic and financial pressures) and Integrity (level of governance of the systems, in such a way as to generate trust in the community in the long term). These sub-indexes weigh 40%, 35% and 25% in the final result of the index, respectively.

The 2023 report also includes some methodological changes in the Integrity sub-index, which decreased the average score of the index by 0.58.

II. Overall Results

The results of the 2023 Mercer Index can be seen in Table 1. Ratings range from A to E. Compared to the 2022 ranking, the Netherlands rises to first place, followed by Iceland and Denmark. The most poorly assessed systems are those of India, the Philippines and Argentina, which once again ranks last.

Kazakhstan is the country best assessed of the additional countries incorporated in the 2023 report, ranking 20th, whereas Croatia and Botswana rank 27th and 37th, respectively. Compared to the 2022 report, Israel moved up to Group A, Singapore moved up to Group B+, Norway moved down to Group B, Portugal moved up to Group B, Malaysia moved down to Group C and Indonesia moved up to Group C.

As in the 2022 edition of the report, there are no systems in group E.

Table 1. Summary of 2023 results

<table>
<tr><th>Grade</th><th>Index Value</th><th>System</th><th>Description</th></tr>
<tr><td>A</td><td>>80</td><td>Netherlands
Iceland
Denmark
Israel</td><td>A robust, first-class, sustainable pension system, with a high level of integrity, that provides good benefits.</td></tr>
<tr><td>B+</td><td>75-80</td><td>Australia
Finland
Singapore</td><td rowspan="2">A pension system with a solid structure and many good features, but requiring some improvements, differentiating it from a category A system.</td></tr>
<tr><td>B</td><td>65-75</td><td>Norway
Sweden
United Kingdom
Switzerland
Canada
Ireland
Chile
Uruguay
Belgium
New Zealand
Portugal
Germany</td></tr>
<tr><td>C+</td><td>60-65</td><td>Kazakhstan
Hong Kong
United States
UAE
Colombia
France
Spain
Croatia</td><td rowspan="2">A pension system with some good features, but also significant risks and/or shortcomings that need to be addressed. Without these improvements, their long-term effectiveness and/or sustainability is questionable.</td></tr>
<tr><td>C</td><td>50-60</td><td>Saudi Arabia
Poland
Japan
Italy
Malaysia
Brazil
Peru
China
Mexico
Botswana
South Africa
Taiwan
Austria
Indonesia
South Korea</td></tr>
</table>

Source: 2023 MERCER CFA Institute Global Pension Index

Table 1. Summary of 2023 Results – Continued

Grade	Index Value	System	Description
D	35-50	Thailand Türkiye India Philippines Argentina	A pension system with some positive characteristics, but with significant weaknesses and/or omissions that need to be addressed. Without these improvements, their effectiveness and sustainability are in doubt.
.	<35	None	A poor system in the early stages of development, or non-existent.

Source: 2023 MERCER CFA Institute Global Pension Index

III. General recommendations

The 2023 Mercer Report acknowledges that each pension system has a unique history, while pointing out that there are some common areas for improvement, as many of these systems will face similar problems in coming decades. Proposals for improvement include:

- Increase coverage of workers in non-traditional employment (GIG economy) and freelancers in the private pension system, acknowledging that many individuals will not save for the future without mandatory or automatic enrollment.
- Increase the official retirement and/or early retirement ages to reflect ongoing and future increases in life expectancy, in order to reduce the costs of publicly funded benefits.
- Promote greater labor participation among the elderly, which will allow them to increase their retirement savings and limit the effect of the continuous increases in the number of years of retirement.
- Encourage higher levels of private savings, in order to reduce future dependence on the public system, while adjusting the expectations of many workers.
- Introduce measures to reduce the gender gap in pensions, and the existing gaps for minority groups in many relevant pension systems.
- Reduce the withdrawal of savings from pension systems prior to retirement, thereby ensuring that the funds saved (often supported by tax incentives) are used for retirement.
- Improve the governance of private pension plans and introduce greater transparency to improve member confidence.

IV. Results in Latin America

Table 3 shows the 2023 results for the Latin American countries considered in the Mercer Index. They rank between 14th (Chile, index value 69.9) and 47th (Argentina - index value 43.3). It is worth mentioning the following regarding the systems in the region:

- In Chile, the observed increase can be directly attributed to improvements in the integrity sub-index (which rose from 79.8 to 84 points), and involves issues such as regulation, governance, protection and communication with members. Hence, a substantial improvement in this country's ranking, through an increase in the adequacy sub-index, is still pending[1].

- The individual accounts of workers in Argentina were expropriated for an amount exceeding US$31 billion (equivalent to 12% of GDP) in 2008 and allocated to a defined benefit PAYGO system. The system currently ranks last, after dropping in the ranking again, compared to 2022.

- The multiple fund withdrawals approved since 2016, and in 2020 and 2021 in Peru, are beginning to affect its index value. The Mercer Report states that this reduction in index value is due to the drop in the level of assets reported by the OECD.

Table 3. Mercer Index ranking, value of the index obtained and reasons for the variation of the index in Latin American countries

	2023		2022		Reasons for index variation
Country	**Ranking**	**Index Value**	**Ranking**	**Index Value**	
Argentina	47th	42.3	42nd	43.3	Review of the scores mentioned in the introduction.
Brazil	33rd	55.7	31st	55.8	Miscellaneous minor changes.
Chile	14th	69.9	16th	68.3	Improvements in regulations.
Colombia	24th	61.9	21st	63.2	Correction of response compared to 2022.
Mexico	36th	55.1	29th	56.1	Review of the scores mentioned in the introduction.
Peru	34th	55.5	30th	55.8	Drop in the level of assets reported by the OECD.
Uruguay	15th	68.9	12th	71.5	Corrected pension coverage data.

Source: FIAP based on 2023 MERCER CFA Institute Global Pension Index data.

[1] Chile's level of adequacy is expected to improve in the next edition of the Mercer Index, mainly due to the updating of the global reports on which it is based, which will consider the implementation of the Universal Guaranteed Pension (PGU) as of January 2022, and which is currently available to 90% of the population aged 65 and over, with the lowest income.

V. Recommendations for improvement in Latin American countries

The 2023 Mercer Report's proposals for the Latin American countries considered in the study are as follows:

Argentina: (i) Increase the coverage of workers in occupational pension plans through automatic enrollment or participation, increasing the level of savings; (ii) Introduce a minimum level of mandatory contributions to a retirement savings fund; (iii) Introduce a minimum age for accessing the benefits of private pension plans; (iv) Improve regulatory requirements for the private pension system.

Brazil: (i) Increase the coverage of workers in occupational pension plans through automatic enrollment or participation, increasing the level of savings; (ii) Introduce a minimum level of mandatory contributions to a retirement savings fund; (iii) Introduce a minimum age of access, so that benefits are preserved for the future; (iv) Allow individuals to retire gradually while receiving a partial pension.

Chile: (i) Increase the minimum level of support for the poorest elderly people; (ii) Increase the retirement age of women; (iii) Introduce a government contribution for those engaged in the care of young children; (iv) Increase the coverage of employer plans, thus increasing the level of assets over time.

Colombia: (i) Increase the minimum level of support for the poorest elderly people; (ii) Increase household savings; (iii) Increase the level of coverage, so as to gradually increase the level of assets; (iv) gradually increase the retirement age, particularly for women; (v) Introduce agreements to protect the pensions of both parties in a divorce.

Mexico: (i) Increase the level of pensions paid to the poorest elderly people; (ii) Increase the coverage of those in the informal market; (iii) Require that part of the benefits of private pension systems be obtained as an income stream; (iv) Increase the level of contributions to savings, increasing the level of assets over time; (v) Improve the governance requirements for the private pension system, including the need for minimum levels of defined benefit (DB) savings plans; (vi) Improve the level of communication of pension plans with members.

Peru: (i) Increase the minimum level of support for the poorest elderly people; (ii) Increase employee coverage in occupational schemes (e.g., by promoting tax benefits or flexible investment rules), thereby increasing savings levels (iii) Reduce early retirement from pension funds; (iv) Introduce a requirement that shows profit projections on members' annual statements; (v) Allow individuals to gradually retire while receiving a partial pension.

Uruguay: (i) Increase the level of individual contributions invested through private pension plans; (ii) Improve governance requirements for the private pension system; (iii) Increase the retirement age as life expectancy increases; (iv) Introduce arrangements to protect all pension interests of both parties in a divorce.

As in previous versions of the report, the suggestions to the countries of the region focus mainly on increasing the minimum level of support for the poorest people, increasing the retirement age in such a way that it reflects the increase in life expectancy, and encouraging both mandatory and voluntary private savings.

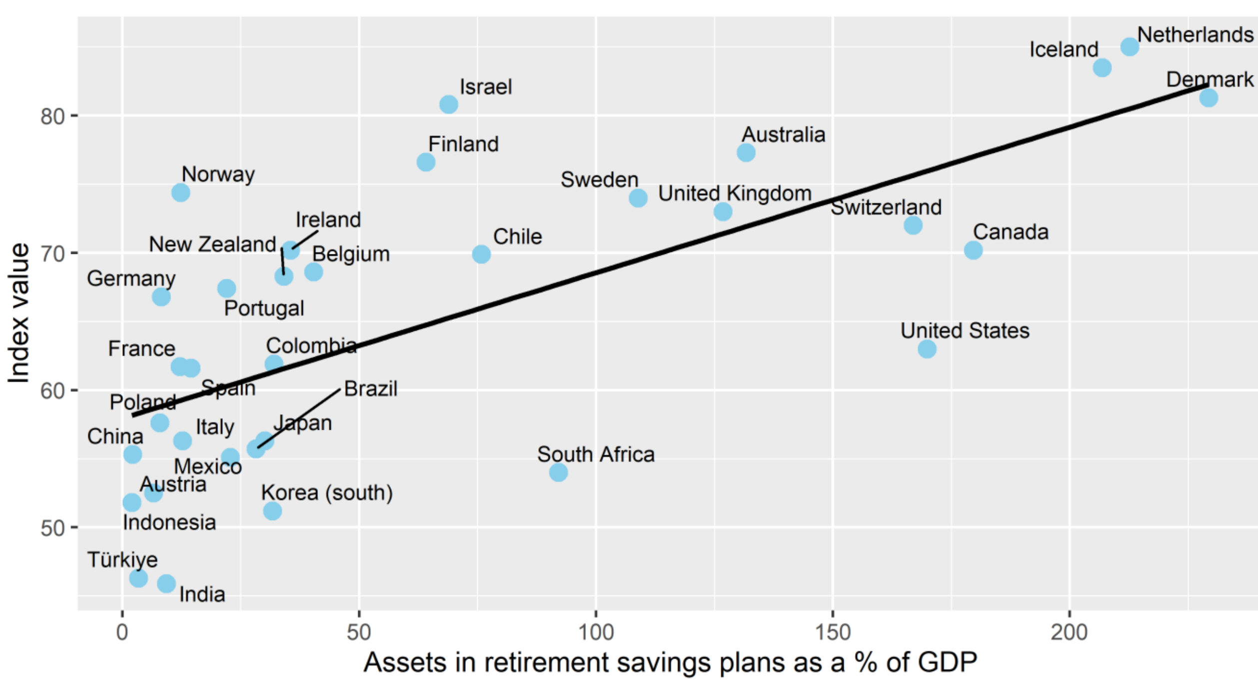
VI. Relationship between individually funded savings levels and the value of the Mercer index

The Mercer Report's recommendations to global and Latin American pension systems, shed light on the importance of private savings, and therefore of individually funded savings systems. Graph 1 shows the relationship between the level of individually funded savings as a percentage of GDP and the value of the 2023 Mercer Index.

The Netherlands, Iceland and Denmark, the three best rated systems, have the highest levels of individually funded savings, exceeding 200% of GDP (found to the right of the chart).

Pension systems like the Japanese and Austrian systems, on the other hand, are mainly PAYGO, with low levels of individually funded savings. These countries have a low index value. The Mercer Report suggests that Japan should reduce the level of public debt and increase the coverage of private pensions, while suggesting that Austria should expand the coverage of occupational plans, in order to increase contributions and savings.

Graph 1. Relationship between the level of individually funded savings and value of the 2023 Mercer Index



Source: Prepared by FIAP based on 2023 Mercer CFA Institute Global Pension Index Report data and Pensions at a Glance 2021 (OECD) data. Since the information is obtained from the OECD, the countries in the graph are those with available information, and not all those considered in the Mercer Report.

VII. Impact of Artificial Intelligence (AI) on pension systems

Mercer's 2023 Report also includes some insights regarding the effects of AI on pension systems. Given that the returns on investments received by members are much higher than the volume of contributions paid during their working lives, the long-term impact of AI on returns will be crucial. The most relevant points made in this regard are:

- AI is already being used for decision making based on data analysis, reporting, risk and market trends. Such approaches can lead to the development of faster and more efficient financial markets.

- AI gives fund managers the ability to analyze large amounts of data from a variety of sources. This type of analysis can identify patterns and detect signals, thus suggesting novel future investment opportunities. This can lead to better allocation of resources and diversification, resulting in higher long-term returns and lower volatility.

- Furthermore, as an increasing number of investors seek to incorporate ethical or ESG factors in their investment decisions, AI presents an opportunity to provide better alignment between investor preferences and investment products.

- On the other hand, AI can predict the behavior of members under a range of economic or political circumstances that may have an impact on future flows of pension funds, which would consequently influence future investment decisions.

So, the expansion of AI should lead to more efficient and better-informed investment processes, producing higher returns for members. However, one must bear in mind that this technology will affect the investment ecosystem, leading to changes in activities, methods, policies and regulations. Such changes can be challenging for certain institutions or agencies.

Conclusions

The Mercer CFA Institute Global Pension Index remains relevant for assessing and improving pension systems worldwide. The regular updating of reports enables monitoring countries and recognizing good practices in pension matters.

Argentina, Brazil, Colombia, Mexico and Uruguay had slightly lower results than the previous year, due to the revision of scores or minor changes. In Peru, the Mercer index has begun to reflect the effects of pension fund withdrawals, as anticipated in previous analyses. The Chilean system, on the other hand, was the only one in the region that increased the value of its index and its ranking, due to a better evaluation of the integrity of the system (better regulation, governance, protection and communication with members).

The updated international data ratify the importance of individual savings in the sustainability of pension systems and consequently, in the value of the index and ranking they obtain. The three best rated countries, namely the Netherlands, Iceland and Denmark, now have private individually funded savings of more than double their GDP.

Finally, according to the Mercer 2023 report, new technologies will significantly improve the pension systems, especially the individual savings systems, since the expansion of AI should lead to more efficient and better-informed investment processes, producing greater returns for members.

Queries: International Federation of Pension Fund Administrators (FIAP).
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