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Global Pension System Rankings Offer Valuable Insights

United States remains behind other countries

In the March 6, 2015, *Benefits Passport*, the American Benefits Institute summarized a series of reports that ranked the pension systems in a number of countries. These studies are potentially very useful to American Benefits Council members in evaluating the strengths of the retirement systems in the countries where they operate. This can help inform decisions regarding retirement plan design and funding strategies to best serve a company's global workforce.

While these reports used a variety of evaluation methods, one of the key findings – even for companies that do not have a large international footprint – is that the United States falls behind the pension systems of a number of other countries. All of the reports assign only modest scores for the United States for what are deemed to be the most significant conditions and design attributes of a retirement income system. It is very important to recognize that these reports examine different aspects of both private sector *and* public sector retirement systems, including overall income adequacy for retirees and the fiscal sustainability of various nations' programs.

Three of these rankings have been updated within the past couple months. While there have been some changes in the evaluation of the U.S. pension system, the overall position of the United States in these rankings remains essentially unchanged. All conclude that the U.S. remains behind a number of European countries, as well as several other systems. Overall, the U.S. continues to occupy a position at about the top third of all countries included in the rankings.

MELBOURNE MERCER GLOBAL PENSIONS INDEX

The longest-running (now in its eighth year) of the ranking systems is undertaken on an annual basis by Mercer in conjunction with the Australian Center for Financial Studies at the University of Monash. **The 2016 study**, released in October, evaluates 27 countries, one more than the previous year with the addition of Argentina. The United States continued to hold the No. 13 spot in the index for 2016.

The study considers each country's pension system and assigns a score between 0 and 100 for three main criteria: (1) adequacy, (2) sustainability and (3) integrity. The scores for these elements are then weighted 40% for adequacy, 35% for sustainability and 25% for integrity to reach a cumulative score for each country.

These main criteria are measured on the basis of five supporting factors in evaluating the ***adequacy*** of each system:

- the projected income replacement rate
- the overall level of savings engendered by the system
- the degree of tax support
- the form in which benefits are received
- the rate of growth in assets

The ***sustainability*** of the system is evaluated in terms of:

- coverage
- total assets
- the level of contribution flows
- underlying demographics
- the fiscal stance of the government

Integrity is measured in terms of:

- the nature of regulation
- governance provisions
- the level of protection for individuals
- communication of information to participants
- operational costs

The United States received an overall score of 56.4 for 2016. This places the U.S. just below the average of 58.1 for all of the countries at the higher end of the group of nations and earns a summary grade of C in the exercise.

The highest rating, with a score of 80.5, was given to Denmark, and the lowest with a score of 37.5 is Argentina. The score for the U.S. was essentially the same as the previous year, increasing by just one one-hundredth of a point. The score for “sustainability” increased somewhat, but was offset by a decline in the rating for “adequacy” and “integrity.”

Denmark, the Netherlands and Australia remained at the top and are the only countries in the index assigned a grade of A or B+. The next-highest group is comprised of Finland, Sweden, Switzerland, Singapore, Canada and Chile. These nations were assigned scores between 65 and 75, thereby receiving an overall B grade.

To a significant extent, the differences in the ratings for the countries in the upper half of the distribution are a reflection of the nature of criteria used to build the overall score. These include an emphasis on the presence of a strong poverty alleviation component in the public system, high levels of pre-funding and asset growth in both the public and private sector components of the nation’s pension system, high participation rates in employer-sponsored pensions that are generally associated with a coverage or sponsorship mandate and a more pro-active regulatory style with extensive government requirements. These are all attributes of the Australian pension system. It is considerably less characteristic of the United States which has relatively modest average income replacement rates in Social Security and a voluntary private pension system with a large number of employer sponsors and, consequently, a comparatively restrained regulatory approach relative to other countries.

How the Countries Compare

Rank	**Mercer** (out of 27)	**Natixis** (out of 43)	**Allianz** (out of 54)
1	Denmark	Norway	Australia
2	Netherlands	Switzerland	Denmark
3	Australia	Iceland	Sweden
4	Finland	New Zealand	Netherlands
5	Sweden	Sweden	Norway
6	Switzerland	Australia	New Zealand
7	Singapore	Germany	Latvia
8	Canada	Netherlands	Estonia
9	Chile	Austria	U.S.
10	Ireland	Canada	Chile
	U.S. (No. 13)	U.S. (No. 14)	U.S. (No. 9)

The most valuable addition in the recent report is the extensive amount of data and analysis of demographic trends and population aging that is presented with projections of workforce participation and old age dependency ratios more heavily weighted in the analysis. This analysis provides an excellent set of summary figures indicating the degree to which increased life expectancy and declining fertility rates will have differing impacts on the pension systems in various countries. This is combined with both observed and projected labor force participation rates to indicate the varying degrees of demographic challenges faced by different countries. In this regard, the United States is found to have less compelling demographic circumstances in comparison to Europe and China.

NATAXIS GLOBAL RETIREMENT INDEX

The latest version of the Nataxis Index is derived from a similar kind of analysis as the Mercer index. In addition to examining the characteristics of the pension systems themselves, the Nataxis Index also takes into consideration access to financial services to generate savings and income in retirement, access to health care and the nature of the environment in which retirees will live. This provides a ranking from the perspective of the overall quality of life offered to retirees rather than a more specific focus on the nature of the pension system.

The 2016 version of the Nataxis Index, which evaluates 43 countries, results in rankings in which countries in Northern Europe occupy seven of the top 10 places, accompanied by New Zealand, Australia and Canada. Norway is rated at the top, followed by Switzerland and Iceland. Denmark, which obtained the highest score in the Mercer Index, is in the No. 12 spot, with the United States at No. 14.

The Nataxis Index looks in particular at four conditions that characterize the retirement environments in each country. These are:

- *Health*, which looks at life expectancy and healthcare costs to the individual and overall expenditures
- *Material Wellbeing*, which looks at incomes levels, their distribution and employment
- *Finances in Retirement*, which considers the overall economic climate in the country, investment markets and institutions and factors that will determine the viability of public retirement benefits
- *Natural Environment/Quality of Life*, which considers factors such as pollution, sanitation and biodiversity.

In this framework the United States receives an overall score of 73%. The U.S. ranks relatively high in the Health index (87%), reflecting the high level of expenditures and access to health care, and in the Quality of Life measure (79%), derived from the relatively clean environment (although constrained by a low level of action on climate change).

The U.S. ranking is diminished by lower scores on Finances in Retirement (71%), due to a high old-age dependency rate and high government debt that is perceived to diminish security. The lowest score of 59% is assigned in the Material Wellbeing category, largely due high levels of income inequality.

Interestingly, although the Mercer and Nataxis studies use very different evaluation criteria, they reach very similar rankings of the various countries they study. This is likely because countries that are on a more sound financial footing and exhibit good governance practices are also able to afford widespread access to retirement savings and achieve good outcomes in the management of long-term savings.

ALLIANZ PENSION SUSTAINABILITY INDEX

Allianz also released **a 2016 version of its Pension Sustainability Index**. This index is more narrowly focused on the long-term financial sustainability of national pension systems and evaluates them in terms of the current structure (given a weight of 75%) and the impact of any reforms that have been implemented since the last version was produced in 2014 (given a weight of 25% to the effects of reforms). In this regard it seeks to combine both structural and dynamic factors.

Overall, the Allianz index concludes that countries have made progress in improving the sustainability of their pension systems over the past two years. This improvement is attributed to the effect of reforms that raise the statutory retirement age in a number of countries and improvements in the underlying fiscal conditions related to public pensions – the share of Gross Domestic Product (GDP) that pension payments represent – as many countries continue to recover following the 2008-2009 global financial crisis.

The Allianz index covers 54 countries and assigns the highest rankings to Australia, Denmark, Sweden, the Netherlands and Norway. The United States holds the ninth-highest score in this evaluation, receiving a value of 7.23 out of 10 which is the same as Chile. The U.S. is given a high score for demographics (the old-age dependency ratio). But this is offset by lower scores for what is determined to be a worsening fiscal situation (increasing expenditures as a share of GDP) and the design of the pension system (relatively low income replacement rates in the Social Security system).

The lowest rankings were assigned to Thailand, China, Slovenia, Greece and Brazil. These countries all have low retirement ages, rapidly aging demographics and benefit structures that are perceived to impose a high fiscal burden in the near future. None have enacted significant reforms to address these challenges in recent years.

In its report Allianz recognizes the inherent tradeoffs between the adequacy of pension benefits and measures of long term financial sustainability. One of the more useful parts of the report presents the relationship between the two measures. This illustrates two issues important to understanding these kinds ranking exercises. It shows how some countries that rank high in benefit adequacy (e.g. Brazil, Japan and Italy) have very low rankings in terms of financial sustainability. It also indicates that a small group of countries (e.g. Denmark, the Netherlands and Norway) have high rankings in both measures. Presenting the two types of measures together moves the United States to a higher position in the hierarchy. This is because the methodology used attributes a higher value to pre-funding of benefits, giving high scores to countries that have developed large pools of assets to fulfill benefit promises, in contrast to those operating on a pay-as-you go basis.

CONCLUSION AND OBSERVATIONS

Developing rankings can be an interesting and useful means to provide a summary and easily accessible assessment of national pension systems. All such exercises, however, need to be carefully considered in light of the methodologies on which they are based. The recently released versions of these rankings, although they differ in their scope and methodology, result in remarkably similar findings. Despite unfavorable underlying demographic conditions, they rank the pension systems of several Northern European countries – as well as the two similar though geographically quite distant countries of Australia and New Zealand – at the top. The United States remains at the edge of the top third of the rankings resulting from all of the methods.

The rankings and these outcomes are in part a result of the sound design of the highest rated systems which provide strong minimum income guarantees through a universal public system, high rates of participation in supplementary plans, and recent efforts to align retirement age with demographic realities. They are also, however, a reflection of distinctive cultural, political and economic environments that are conducive to benefit mandates, pro-active regulatory structures and – most importantly – a legal framework and market conditions that are conducive to the pre-funding of benefits.