



INNOVATION AND IMPERATIVES IN FINANCIAL SECURITY SYSTEMS

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These views are not necessarily those of my employer

Introduction



- **This paper is a summary of work that I have done for, and after, the Taylor “Inquiry into a comprehensive social security system for South Africa” where I convened the Old age and insurance sub-committee**
- **It identifies what imperatives (values) that I believe ought to be applied universally**
- **... and attempts to embody them in the practical design of financial security systems, the precise design of which will depend on local circumstances and variations of the universal imperatives**
- **In other words, I do not expect people will agree with everything, but I do want to challenge thinking that rejects any of the imperatives!**

The Structure of the Financial Sector – our world

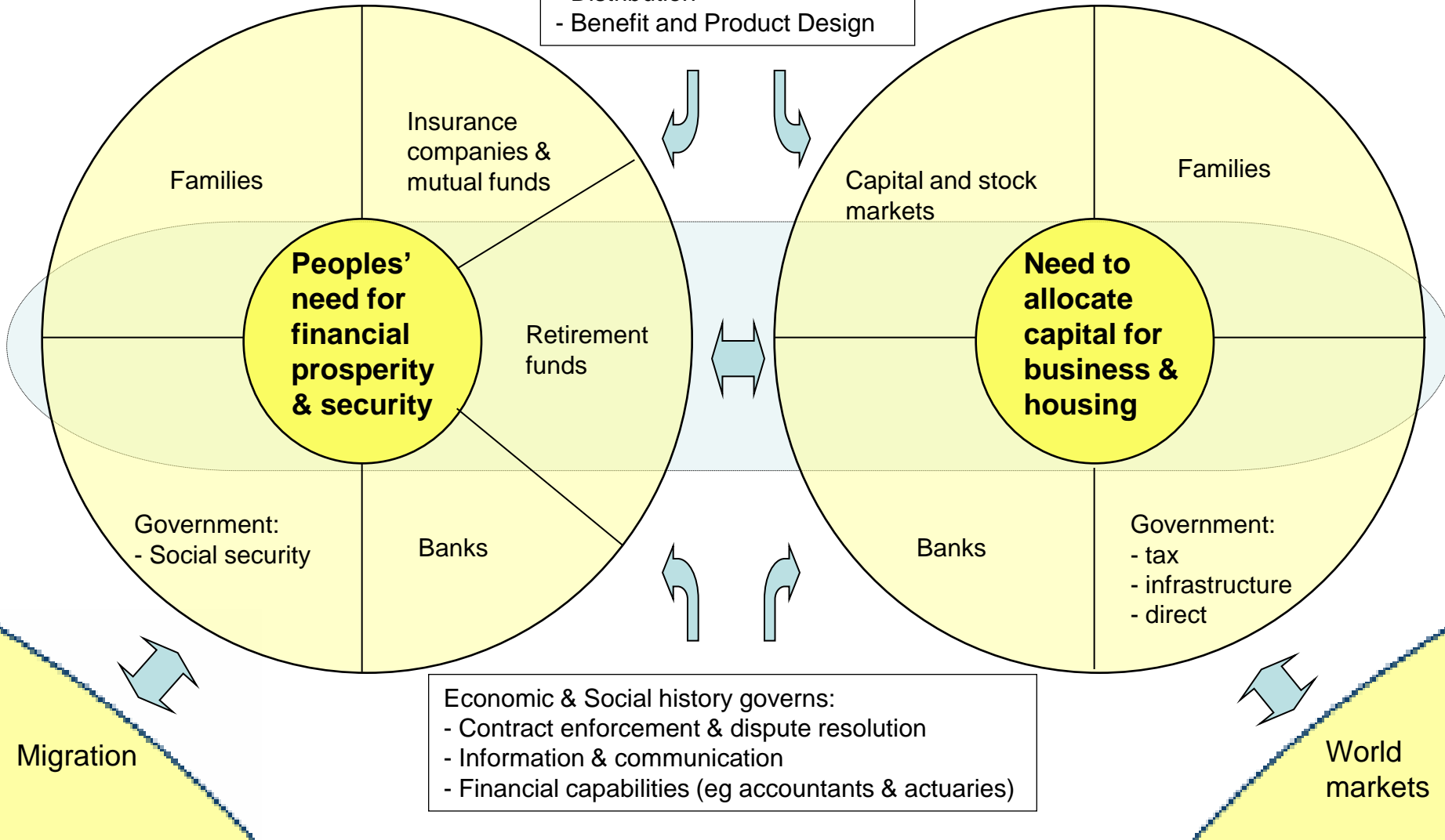
Objectives:

- Integration & formalization
- Efficiency & innovation
- Freedom & wellbeing

Systematic risks:

- Economic (Oil, China ...)
- Societal (Families, war ...)
- Physical (Global warming ...)

Law and regulation governs:
- Organization structure
- Distribution
- Benefit and Product Design



Economic & Social history governs:
- Contract enforcement & dispute resolution
- Information & communication
- Financial capabilities (eg accountants & actuaries)

Migration

World markets

Justice: our standard

"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



Blindfolded - to
personal and
vested interests

Swathed
woman with
scale
emphasises
process

Sword
indicates
power to
exercise
discretion



Weighed – carefully – in the scales:

- All the stakeholders
 - Members
 - Families
 - Institutions
 - Government
 - Public
- Major criteria
 - Just deserts (Actuarial equity)
 - Liberty (non domination)
 - Equality
 - Individual need
 - Efficiency

Some justification of the model



- Philosophical
 - Just deserts and virtue: Aristotle, Thomas Aquinas, Alistair Macintyre
 - Equality and efficiency/capability: John Rawls, Amartya Sen
 - Utility and Freedom: JS Mills and most economists
 - Need and the protection of the weak: Isaiah
- Legal embodiment
 - Common Law and Equity
 - Universal declaration of human rights and constitutional rights
 - Court decisions
- Dilemmas: those who do not recognise:
 - Equality
 - Just deserts
- Lemmas
 - Subsidiarity
 - Indignation

“For discussion on different approaches, see: “Whose justice? Whose rationality?” Alistair Macintyre

“Blessed are those who hunger and thirst for justice” Jesus

Differences with World Bank criteria – some challenges



Subsidiarity – minimise centralization of power

- All power corrupts – segregation of duties

Actuarial equity (just deserts) is the only real basis for
“adequacy, affordability, sustainability and robustness”

Remove distortions created by government intervention or monopolistic practices (on grounds of liberty as much as efficiency) – and against the “promotion” of savings as there is no evidence that it creates growth.

Redistribution



- System should include a package to meet basic needs
- Should be seen as a whole: tax and means tests, benefits, deductions and subsidies – the progressivity of individual elements is not critical
- Horizontal and vertical equity mean monotonically increasing marginal rates of tax and clawback
- System should not be intrusive, not create perverse incentives and minimum disincentives to work
- Redistribution can be justified by need, equality and the elements of chance in wealth

Disability benefits

– looking closer



Heterogeneity of needs

- Physical – requires rehabilitation
- Intellectual – requires assistance
- Depression and backache – requires activity
- Totally incapacity – requires income replacement

Current systems often (un)lucky dip

- Cover depends on irrelevant causes (workers comp ...)
- Gaps and overlaps (lump sums, traumas ...)

DC better than DB – logically



(Assuming flat pension funded from revenue, and ignoring transition issues)

NDC better than DB

- Actuarial equity is robust, subsidies are transparent, fewer power games

DC invested in government bonds better than NDC

- More security & better accounting: all liabilities on the balance sheet

DC with investment freedom better than none

- More efficient capital markets, and expectation of greater pensions

Democratically controlled private funds better than state run

Subsidiarity: efficiency differences are insignificant if funds are large

Investment risks ... and transparency



Government guarantee should be priced by market

- Anything further is an unjustifiable subsidy to the rich
- Better to spend money on increasing the basic pension

Employer guarantee can also be priced at market

- Increased risk to member if employer fails
- No obvious benefit except for opportunists

Other ways to share risk and smooth returns in a
market consistent fashion esp. post-retirement

Personal implications



Personal responsibility and opportunities:

Regulators (in government and compliance functions)

- To do justice when we have power

Business practitioners

- To be creative - Drucker: “the main purpose of business is innovation”

Researchers

- To consider imperatives as well as facts