Reform of the Fiji National Provident Fund

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Reform of the Fiji National Provident Fund

- The problem:
  - From 1975, retirees from age 55 could elect to convert part or all their balance into an annual pension of **25**% of their conversion sum
  - Reform in 1998 phased in reduction to conversion factor down to **15**% over period 1999 to 2008
  - Conversion at 55 of 25% created additional liability of **3** times the conversion amount; even 15% created additional liability of **1** times conversion amount
  - By 30 June 2011 FNPF was technically insolvent

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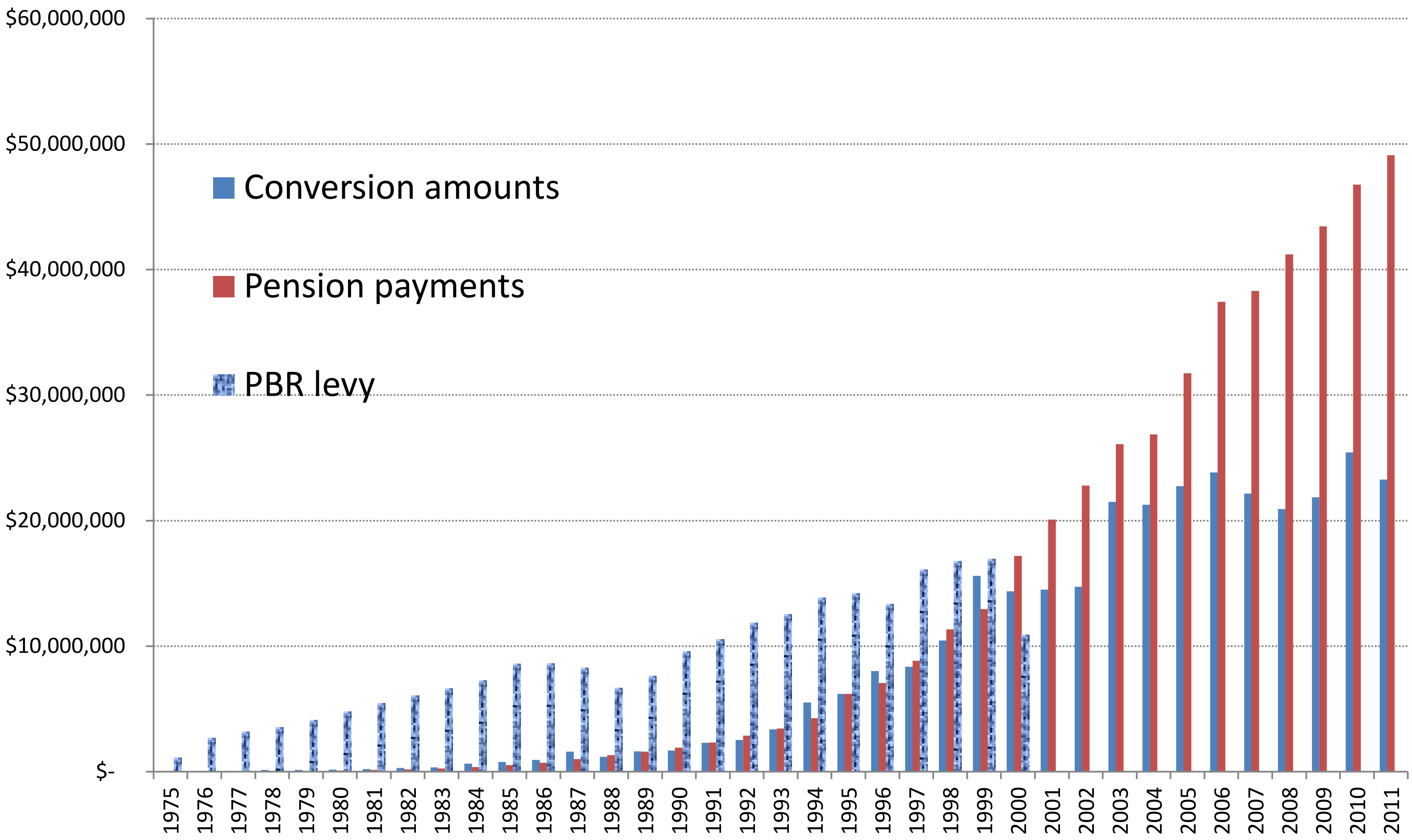
Operation of the Pension Buffer Reserve (PBR)



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- PBR levy
  - Original member contribution was 10% of wages (5% employee, 5% employer) starting 1966
  - With introduction of pension option in 1975, additional 2% levied (1% ee, 1% er) to support pensions
  - Represented a subsidy since most members did not elect a pension
  - Described by World Bank in 2007 as “a heavy cross-subsidisation from poorer and younger workers to older and richer ones”
  - Levy ceased 2000

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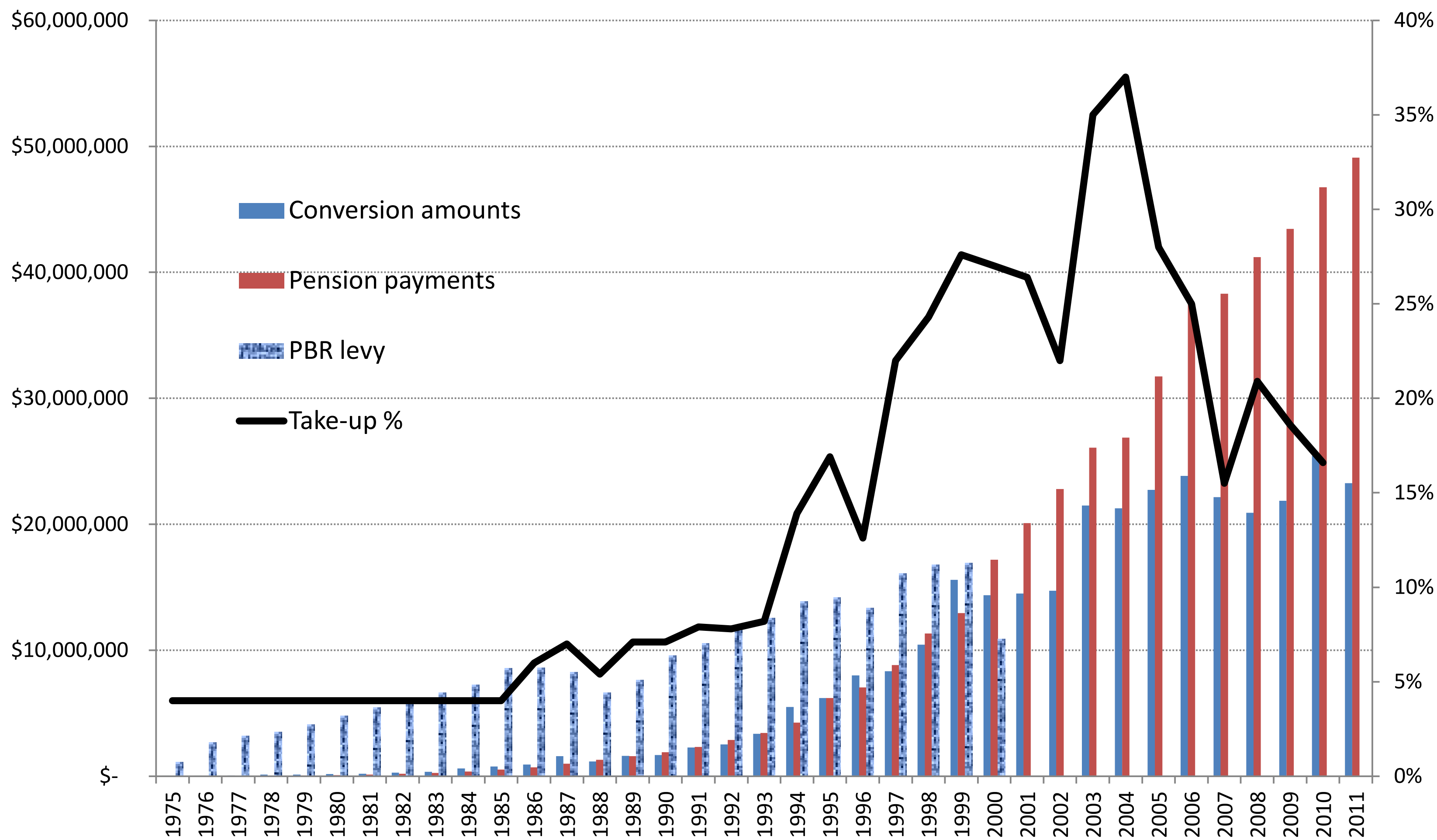
Operation of the PBR with take-up by number



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- Financial assets

30 June 2011	(m)
Government bonds	$2,063
Quasi-gov't bonds	$366
Term deposits	$232
Loans & advances	$393
Equities	$64
Equity in subsidiaries	$276
Property investments	$86
Cash	$182
Total	**$3,662**

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- Solvency

30 June 2011	Before reform (m)
Total assets	**$3,768**
Member accounts	$2,997
Solvency reserve for above	$300
Pension liability	$565
Death benefit reserve	$19
Total liabilities	**$3,881**
(Deficit)/Surplus	**($113)**

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- The solution:
  - Total conversion amounts for current pensioners = $**310** m compared to liability of $**565** m
  - Hence pay back investment and invite and encourage to re-invest in sustainably priced pension
  - Analogy is with bond: coupon far in excess of what could be earned, hence repay without penalty
  - Analogy incomplete inasmuch as bond has value on death; however, at age 55, margin of 2-300 basis points as compensation more than adequate

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- Solvency revisited

30 June 2011	Before (m)	After (m)
Total assets	**$3,768**	**$3,768**
Member accounts	$2,997	$2,997
Solvency reserve for above	$300	$300
Pension liability	$565	$310
Pension solvency		$31
Death benefit reserve	$19	$19
Total liabilities	**$3,881**	**$3,657**
(Deficit)/Surplus	**($113)**	**$111**

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- Use of surplus:
  - Reductions resulting from applying sustainable age-based rates are of order of 40-50% at ages 55-65
  - Hence determined to use surplus to mitigate effect at bottom end and provide some encouragement to re-invest at top end
  - Several possibilities discussed and actuarially costed
  - Eventual design gave rise to “top up” pensions at three levels depending on new and old pension levels
  - Top up available only if total reconversion to pension

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Distribution of monthly pensions

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- Top up basis
  - For those for whom both the old and the new pension was under $100 per month: a top up to the new pension such that the total is $100 per month
  - For those for whom the old pension was between $100 and $300 per month: a top up to the new pension to take the total to the old pension total
  - For those for whom the old pension was over $300 per month: the higher of
    A. A top up to the new pension to $300 per month
    B. A top up pension purchased by 25% of the conversion amount capped at $10,000

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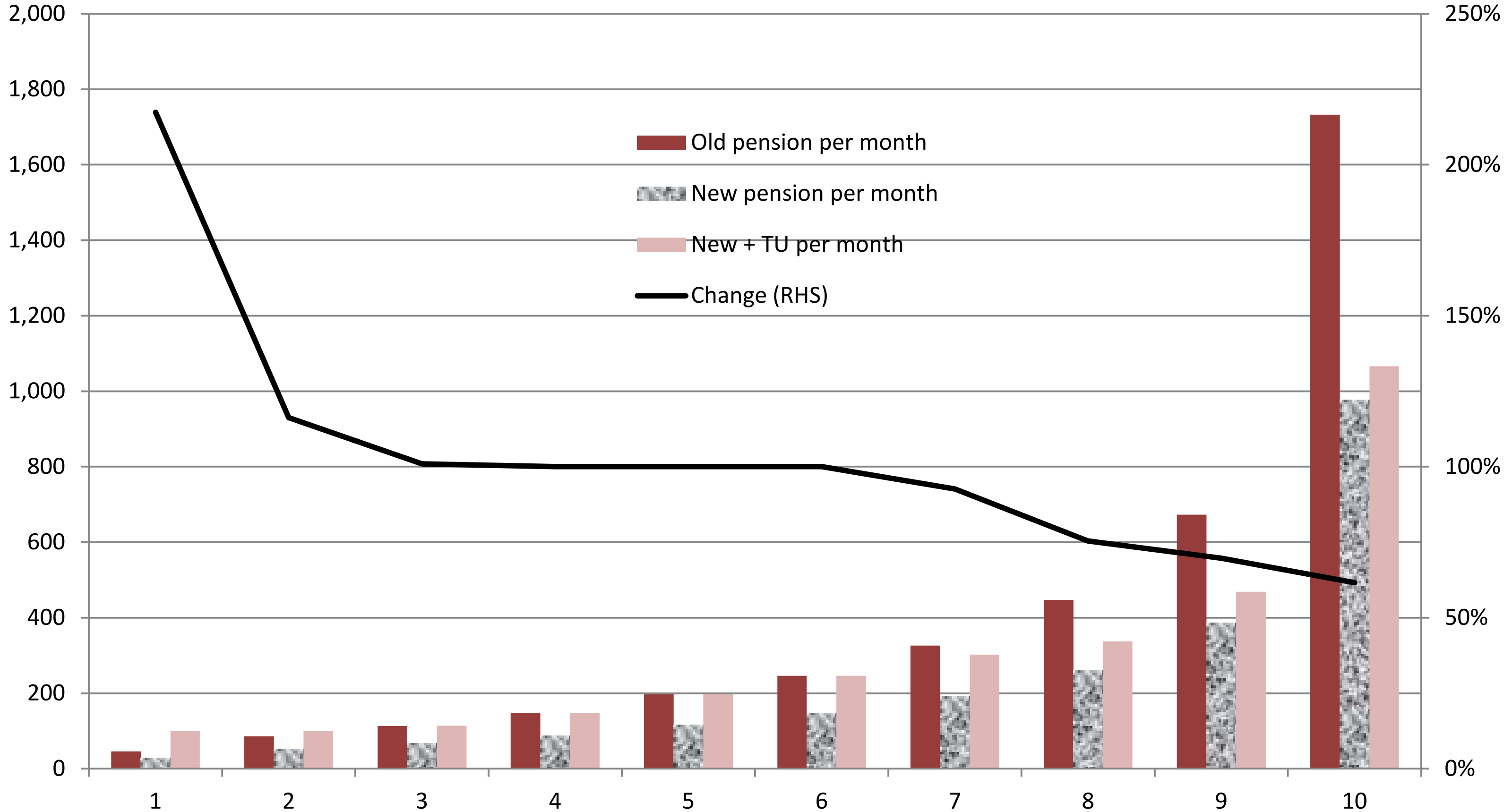
Distribution of top up and effective reduction



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- Top up effects
  - Some 2,000 better off
  - Another 5,000 stay the same
  - The next 2,000 face reduction between 0-30%
  - Average value of top up not too different across deciles
- Implementation
  - Pension counselors held face to face meeting
  - Explain options
  - And validate …

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- Take up
  - Preliminary indication of 70% take up of pension by number
  - For some others, opportunity to receive lump sum very welcome
  - Some have also chosen a new term annuity option

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- Objections raised
  - Some misunderstanding, also some misrepresentation
  - Some of the arguments put forward:
    a. Current pensions are sustainable
    b. The FNPF is breaking contracts
    c. The FNPF legislation incorporated a Government guarantee
    d. The Pension Buffer Reserve was misused
    e. Pensioners are being forced to pay for bad investment decisions
    f. Pensioners have budgeted for the future and now have to readjust without the capacity to replace earnings

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- Current pensions are sustainable?
  - Two aspects: (a) past rates were OK, (b) regardless of that, money available for future
  - Past rates, even at 15% conversion, justifiable only if high pensioner mortality
  - Exercise of outcome of PBR excluding levy is deficit of $170 million
  - Allowing estimate of credit for own levy payments reduces this to deficit of $100 million
  - For future, FNPF now insolvent without cross subsidy
  - Subsidy needed calculated as reducing member accumulations by 30% over working lifetime

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- The FNPF is breaking contracts?
  - Is a legal question, not actuarial
  - Entitlement is statutory
  - Purchase price is being returned and past reward has been more than fair
  - Option to segregate
  - Option to hypothecate
- However ....
  - Legal challenge opportunity removed by legislation
    - Motive was to eradicate implementation delay
    - But suggests independent review & report desirable

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- The FNPF legislation incorporated a Government guarantee ?
  - In fact is a liquidity guarantee, ie will make advance but has to be repaid
  - No other guarantee

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- The Pension Buffer Reserve was misused ?
  - Argue that should have been operated as a fund, with interest credited
  - But was never meant to be a fund, and doing so would have exacerbated transfer from contributors to pensioners
  - Interest credited to member accounts in the 90's was higher than return on investment, but recent pensioners obtained benefit too
  - Over last few years crediting rate has been below return on investment
  - Allowance for pensioner own levies does not alter deficit position

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- Pensioners are being forced to pay for bad investment decisions ?
  - Have been some mistakes
  - But these impact on contributors to much greater extent overall than on pensioners

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- Pensioners have budgeted for the future and now have to readjust without the capacity to replace earnings?
  - This has validity – although ..
    - Impact is at top end, where more capacity to adjust
    - Some in a position to continue in work and obtain additional pension
  - Nonetheless, is acknowledged that this was not a desirable outcome
  - But: choice was between continued subsidy of past members who elected pensions, and ensuring future contributors build up worthwhile retirement balances

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- CONCLUSION
- This presentation has focused only on change to current pension entitlements
- Reform has also made significant improvements in governance, transparency, and separation of business
- In respect of pension change, though, will finish with the following view expressed by a colleague in the process:

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"There are no losers; but there are a few who have stopped winning at others expense"