Early Bird Seminar on "Looming Old-Age Crisis for Retired Pakistanis"

This well-attended seminar was held on 5 April 2007 at Karachi. Our presentation has been placed on our web-site www.akhasan.com.

The central theme was that there are currently about 9 million Pakistani men and women aged 60 or more. In 20 years, the number is projected to double to 18 million. The question of delivering old age pensions to them should be tackled now.

Existing approved pension schemes and other separation benefit schemes, like provident funds and gratuities, as well as the Voluntary Pension Scheme (VPS) soon to be launched, are good in themselves. But they are aimed at relatively well off people. They are irrelevant for the great majority of Pakistanis over 60, who will remain outside these schemes.

The solution proposed by Commissions and Committees, constituted by different Governments during the last 15 years, is to have a National Basic Pension Scheme. This would provide basic pensions, not wage related pensions, to persons over 60. Its scope would be expanded in phases to cover the entire working population.

Unfortunately there has been zero action on these recommendations. Article 38-C of our Constitution requires the state to provide social security by compulsory social insurance or other means. Action should be initiated now. As a nation, we can no longer postpone the issue.

There was a lively discussion after the presentation. One suggestion was that the question of medical facilities to old people should be also be tackled.

Base DC retirement planning on real returns, net of inflation and taxes

The Early Bird presentation also addressed the issue of Defined Contribution schemes for retirement, whether sponsored by employers or bought by individuals under the VPS.

The contributions required should be based on real investment returns, net of inflation and net of taxation. In current conditions, the real return may be (-1) % to 2% pa.

Illustrations based on nominal returns of 9% to 11% pa in current conditions, which ignore inflation and taxation, would greatly under-state the saving effort needed to provide for old age. They would lead to disappointment, dis-illusion and an impoverished old age.

Increased Paid Up capital required for life and non life insurers

On 10 April 2007, the SECP increased the minimum Paid Up capital to Rs 500 million for life insurers (and family takafuls), from Rs 150 million. For non life insurers (and general takafuls), the new minimum is 300 million, compared with 80 million previously.

"Those who initiate the registration process in future shall be required to [have the increased capital]". Existing insurers may comply in stages, according to the following table.

Existing	Min PUP capital (Rs millions) by 31 Dec of year				
	2007	2008	2009	2010	2011
Life	350	400	450	500	500
Nonlife	120	160	200	250	300

The new minimum may not be enough in practice. Potential entrants would do well to arrange for a professional feasibility study to get a better idea of capital required.

Akhtar & Hasan (Pvt) Ltd **Actuaries**
3rd Floor (Annexe), State Life No 1 Building, Chundrigar Road, Karachi 74000, Pakistan
Phones + 92 (021) 111-00-00-53 Fax + 92 (021) 241-7810 E Mail actuaries@akhasan.com
www.akhasan.com

Pros and Cons of Defined Contribution and Defined Benefits

There has been a world-wide trend for commercial, industrial and other employers to switch from Defined Benefits to Defined Contribution pension schemes.

DC enables the employer to avoid future salary, investment and longevity risks. He also avoids the fluctations in pension cost reported under various accounting standards, and the cost of complying with accounting and other regulations on DB.

In the January 2005 issue of the US Society of Actuaries *Pension Section News*, Mark Ruloff pointed out that by switching to DC, employers would incur other risks, in the area of recruitment, retention and employee morale. In the April 2005 issue, Samee-ul-Hasan observed that most employers seem willing to face these other "soft" risks, rather than the "hard" financial risks under DB.

Problems with Chilean National Pension System

Under the Pinochet Government, Chile switched its national pension scheme to Defined Contribution. The wage related contributions were channelled, at the choice of the participant, to competing privately run pension funds (AFP's). However, as pointed out by Samee-ul-Hasan in a contribution to the *North American Actuarial Journal*, this switch was possible only because the Chilean Government guaranteed that the pension under the DC system would not be less than a defined minimum pension.

There are signs that the glamour has worn off the Chilean system. Participants had to bear marketing and asset management costs. These are zero under a state run pay as you go scheme. Administrative costs are also usually much higher. Some AFP's did not do well.

There is also a conceptual flaw in the Chilean system. A national pension scheme should not provide wage related pensions. It should aim at a basic "subsistence" pension. Wage related pensions are important, but should be left to employer-sponsored schemes, or schemes for which individuals pay. Those schemes should be encouraged in other ways, but not merged with the state national basic pension. This was also the view of the World Bank's 1979 Report *"Averting the Old Age Crisis"*.

"Horses for courses": national basic pension scheme must be open group.

DC, or properly financed DB based on closed group costing, are the only horses good for pension schemes of employers. For schemes bought by individuals, DC is the only horse.

But for a national basic pension scheme, the only horses that can last the course are schemes based on open group costing. The open group costing could be "scaled premium", as in Pakistan's EOBI. Or it could be "pay as you go, with long range actuarial balance", as in US Social Security. Pay as you go was advocated by the World Bank's "*Averting the Old Age Crisis*".

To quote from the Early Bird presentation on 5 April 2007 "DC schemes are irrelevant for national basic pension schemes. There is no way the majority of old Pakistanis can pay for their pensions out of accumulated savings. There has to be an inter-generational transfer, and the scheme has to be based on open group costing. Such a National Basic Pension Scheme is Social Insurance, and not commercial pension business".

Impure thought on pure gold leaders

Pure 24K gold is too soft for anything to be made out of it. It must be alloyed with some base metal. Maybe the ideal leader, whether in business, politics or whatever, should be 18K to 22K.