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Mercer and World Economic Forum

Future of retirement and healthcare in a rapidly ageing world - challenges, scenarios and strategic options

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www.mercer.com

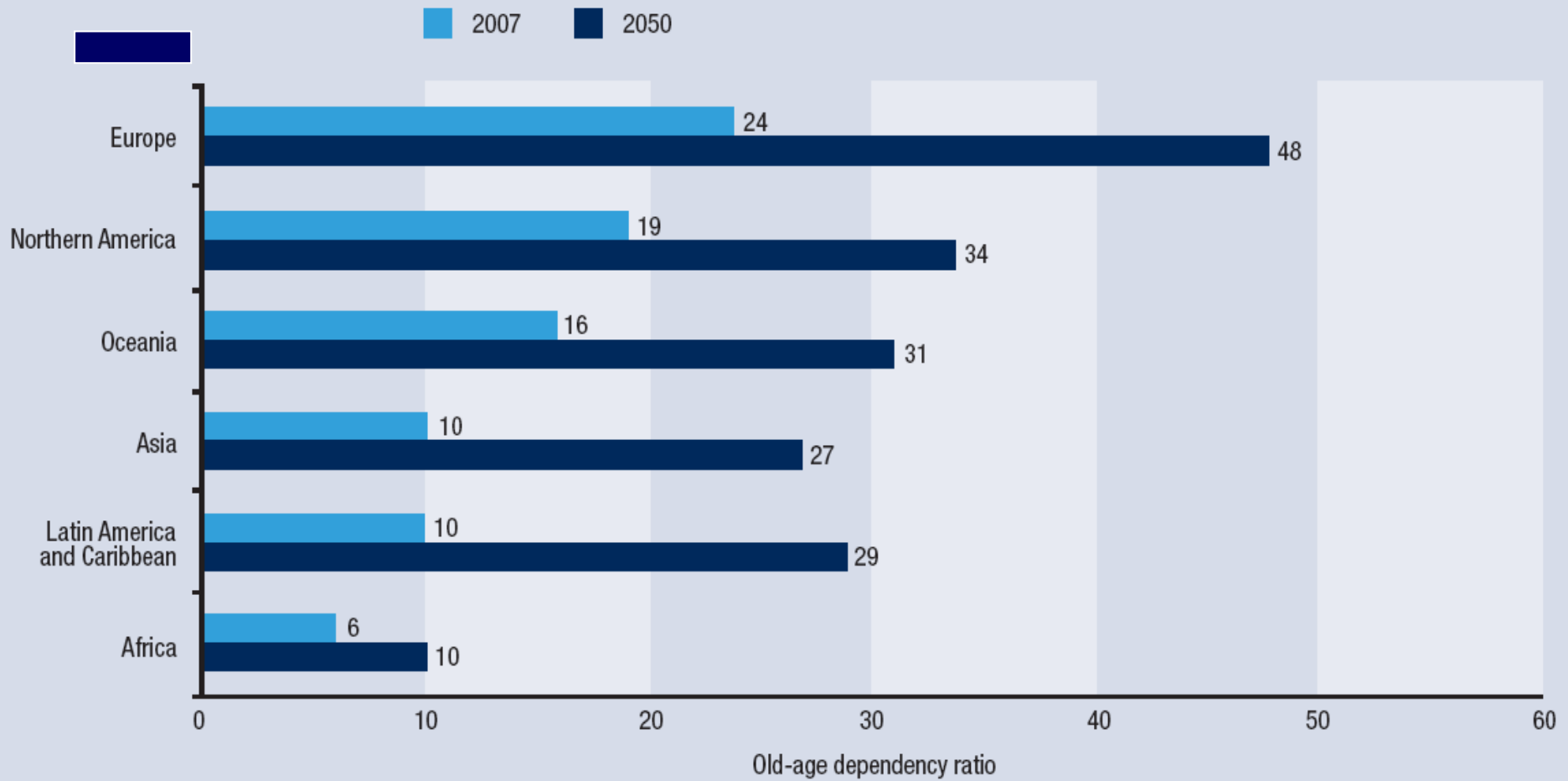


Today's Agenda

- **The problem**
- The process
- The possibilities for employers

The world is ageing rapidly

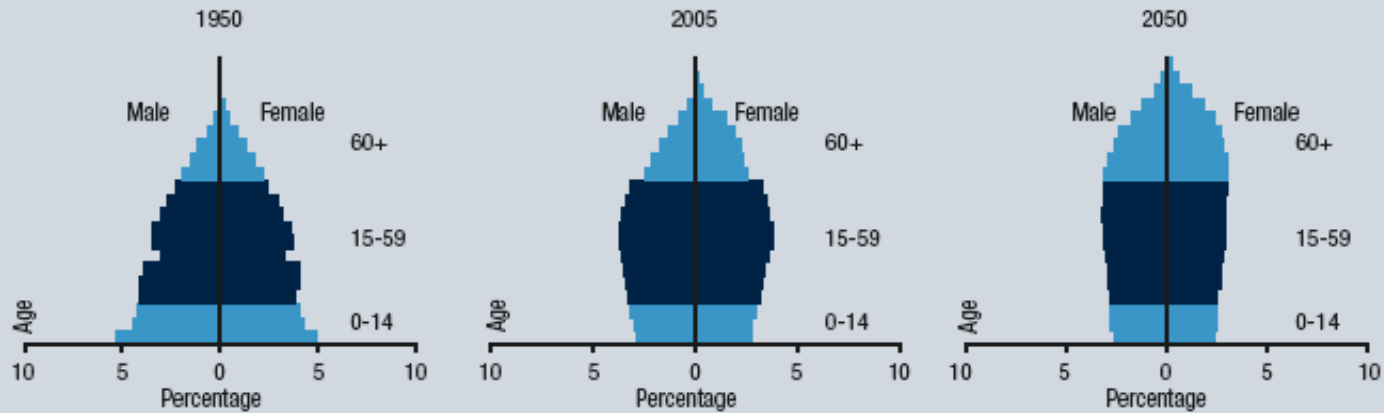
Figure 1.2 **Old-age dependency ratio (%) in major areas, 2007 and 2050**



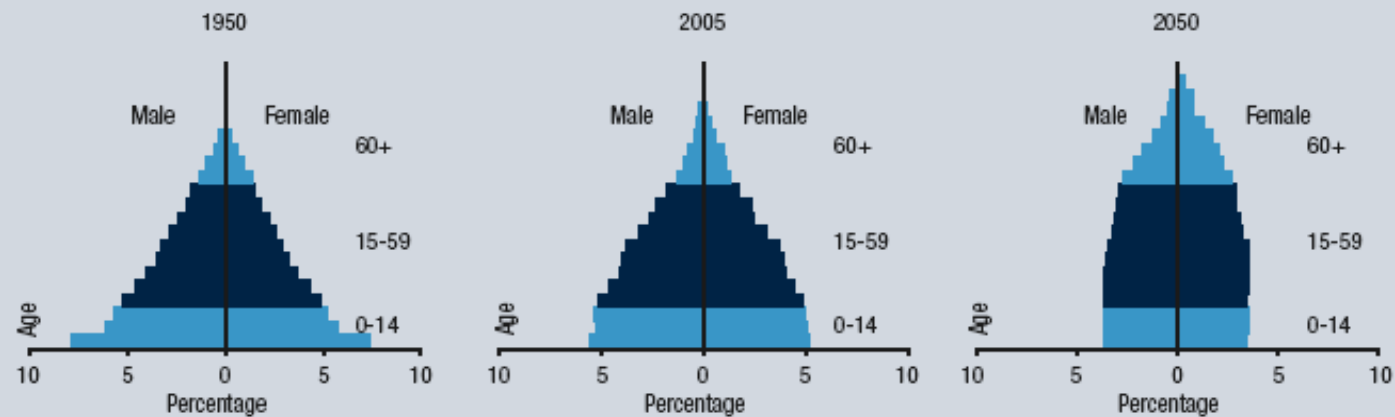
Source: United Nations (2007)

Population shapes will look very different for the next generation

Figure 1.1 Population pyramids – developed countries



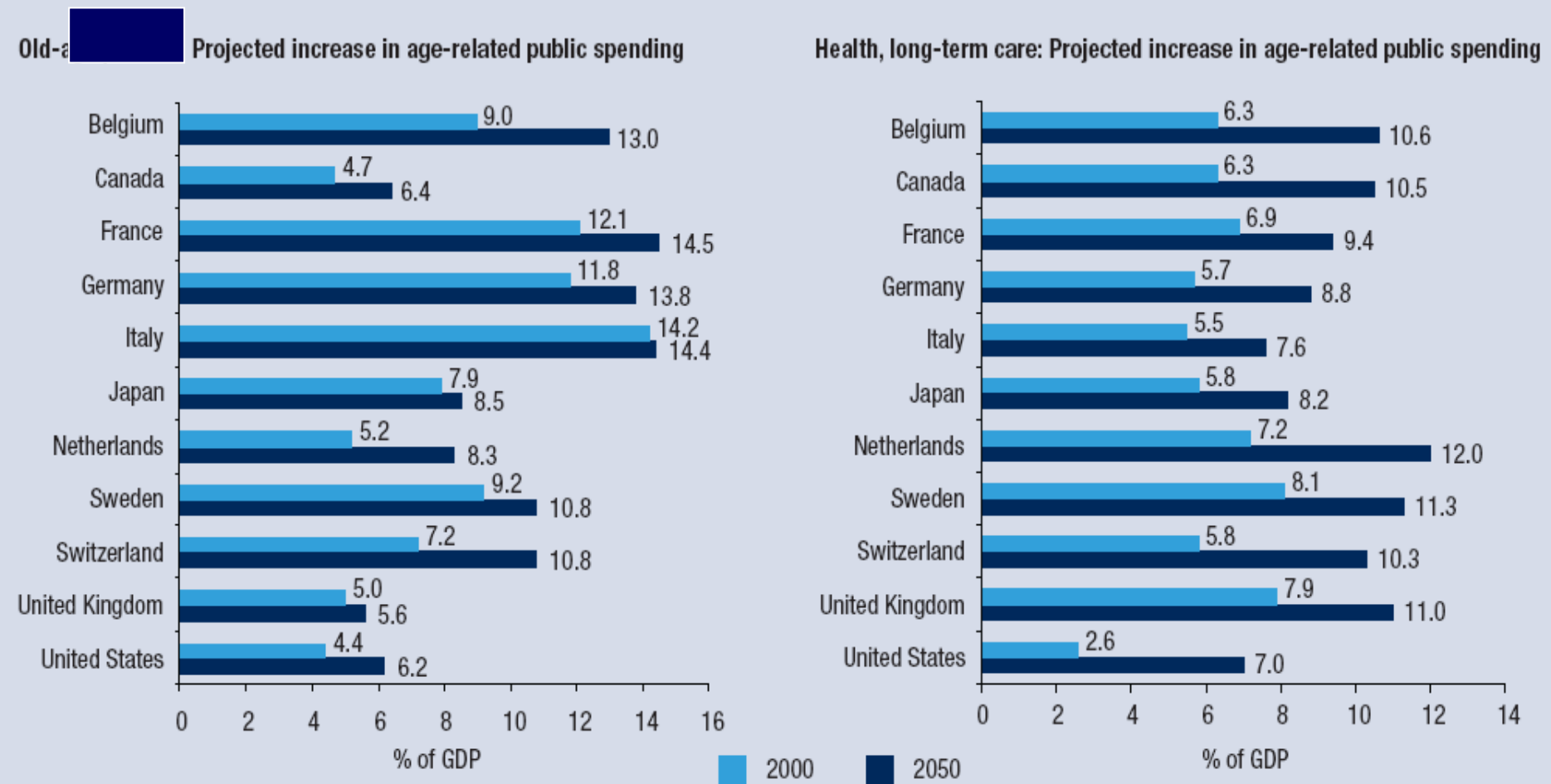
Population pyramids – less developed countries



Source: United Nations (2007)

With a major impact on public pension and healthcare spending

Figure 1.3 **Projected increase in ageing-related public spending, 2000-2050**
(Assuming unchanged policies as from the early or mid-2000s, in % of GDP)



Source: OECD (2005)



Today's Agenda

- The problem
- **The process**
- The possibilities for employers

Overview of the Phase 1 Study – A review of global drivers of change

Demographic Shifts

Global Economic Performance & Investment Returns

Income/Wealth Distribution - Emerging Markets

Changing Patterns - Infectious/Chronic Diseases

Climate Change & Environmental Degradation

Urbanization

Changing Attitudes of Individuals to Retirement and Health

Changing Role of Governments in Social Welfare

Changing Role of Employers in Social Welfare

Changing Role of Families in Social Welfare

Healthcare Innovation & Regulation

Financial Innovation & Regulation



Overlaid with regional and national drivers of change for China & Italy

Regional/National Drivers

Both

Demographic shifts

National economic performance

Architecture of the health system

Progress on pension reform

HR and Labor market reforms

Italy

Regional Wealth Distribution

Immigration

China

Urban/rural wealth distribution

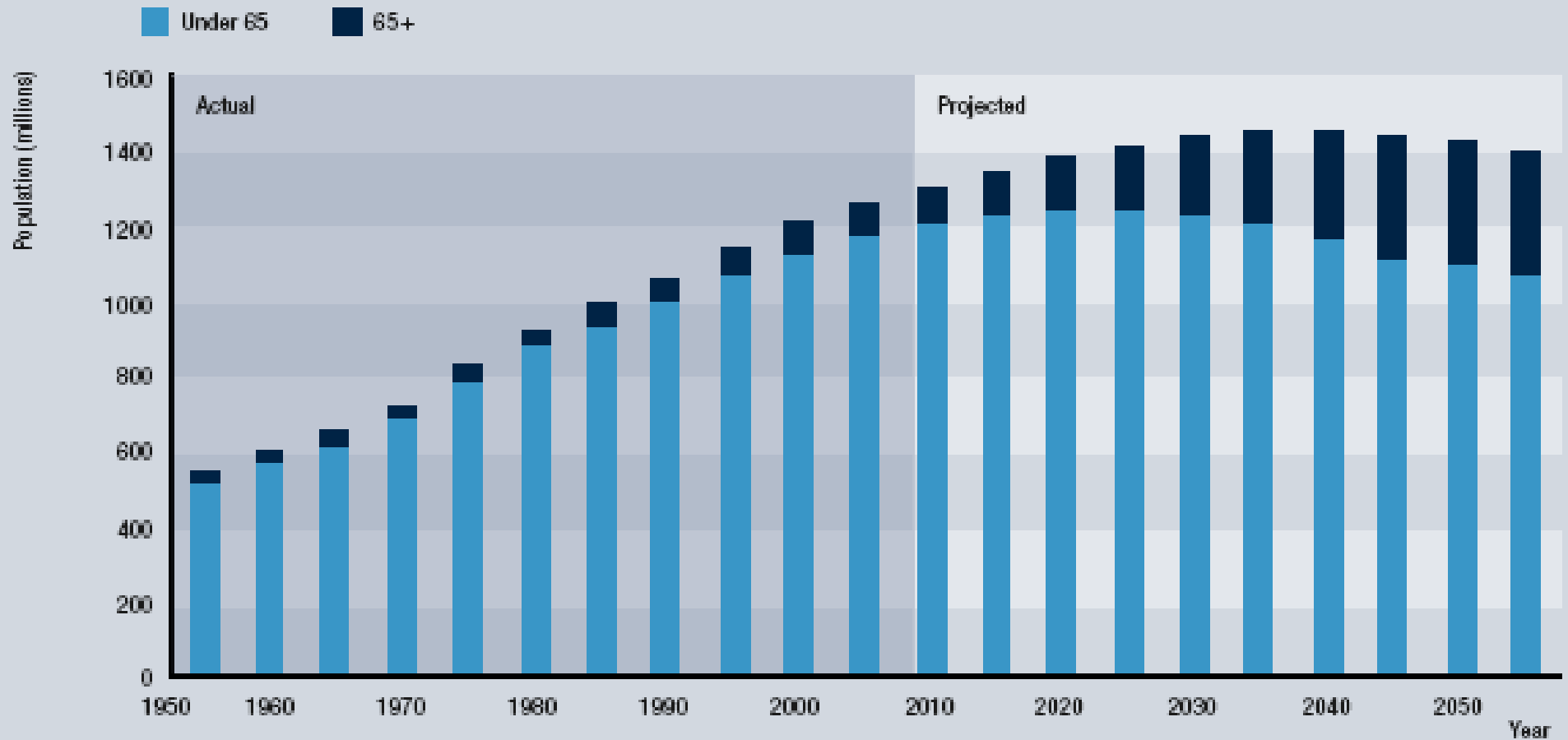
Social tension/instability

Urbanization and informalization



Why China? – The emerging elderly

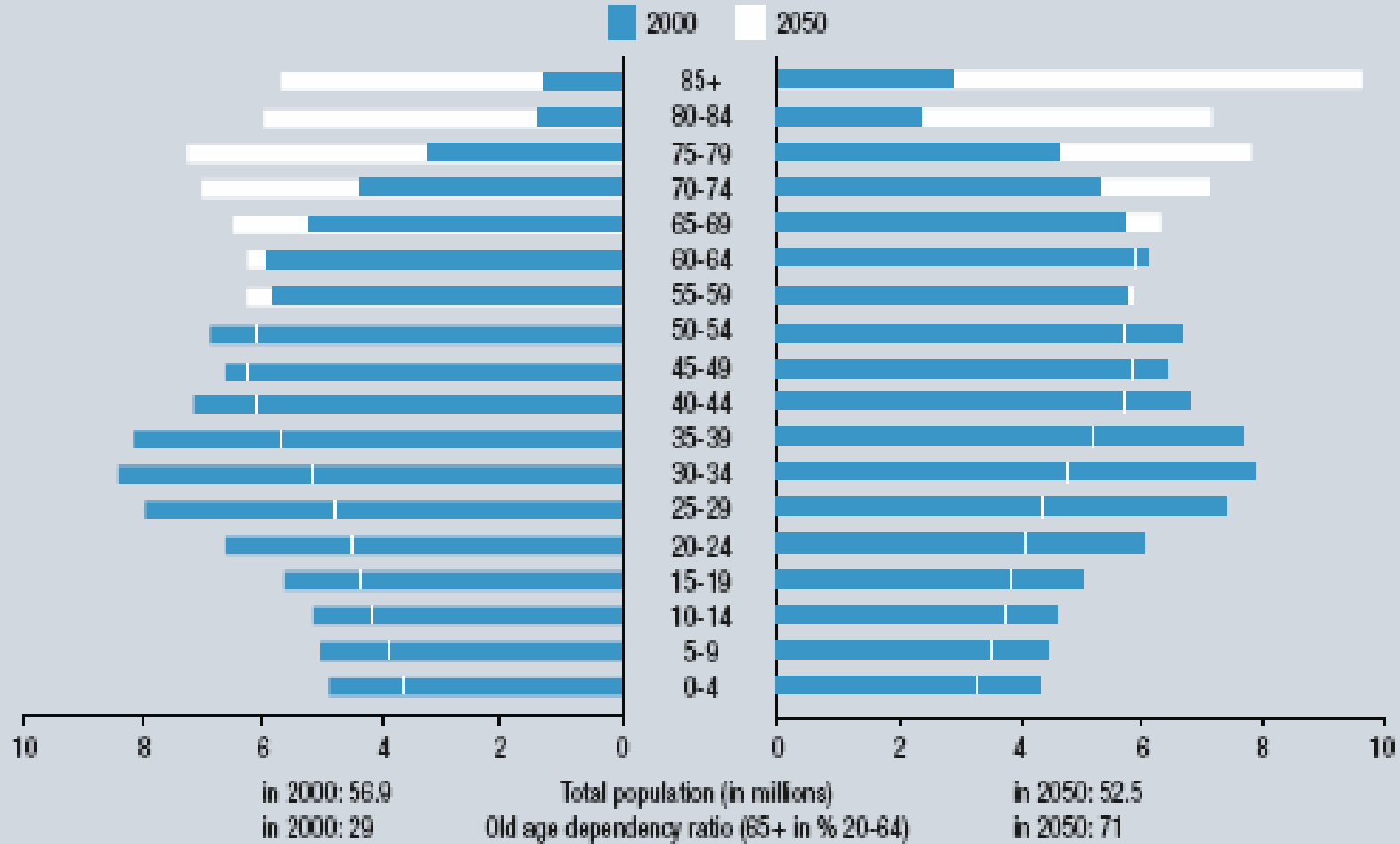
Figure 1.7 The increasing Chinese population share above 65 years of age



Source: United Nations Population Fund (2008)

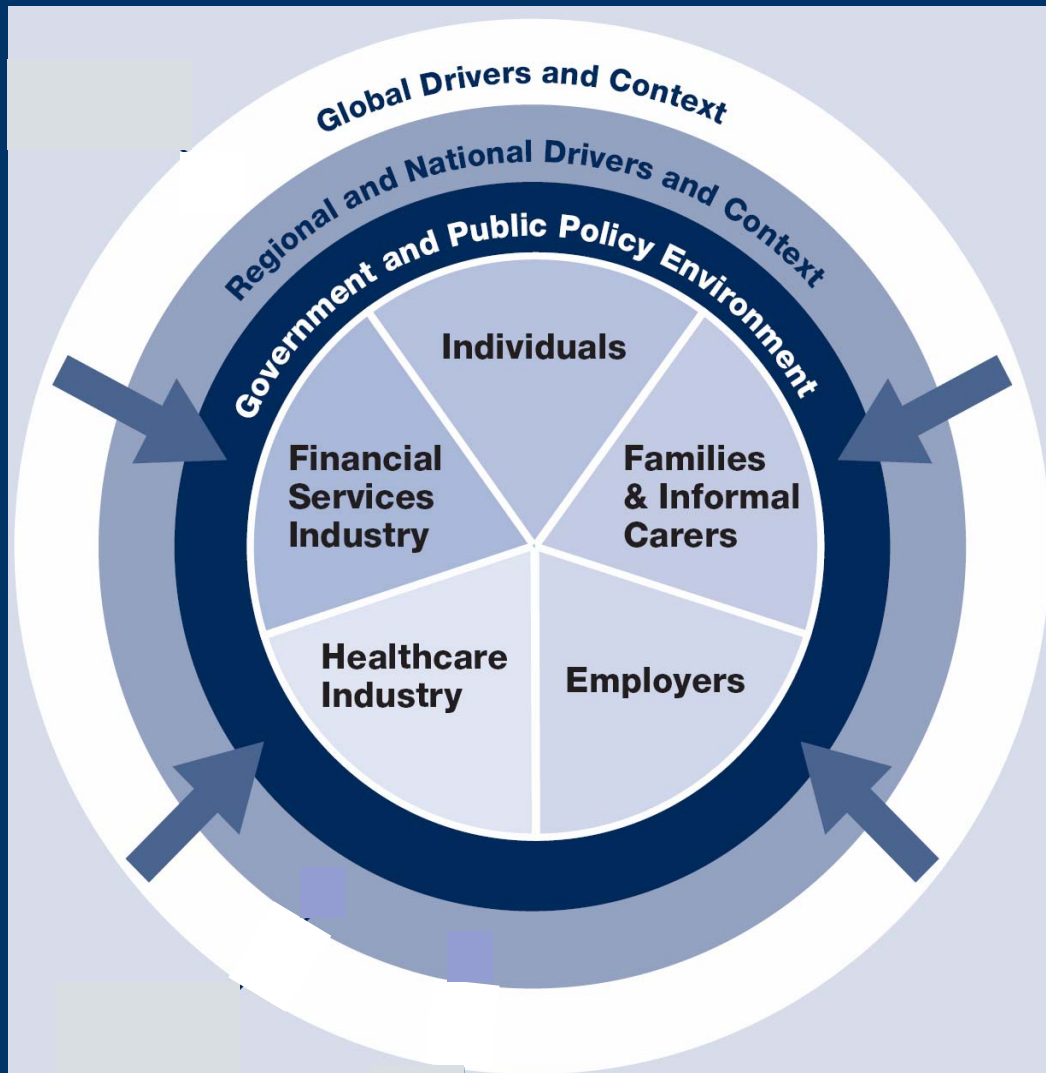
Why Italy? – Europe’s oldest population – with more to come!!

Figure 1.12 Population pyramid – Italy



Source: OECD (2006)

Overview of the Phase 1 study – the key questions

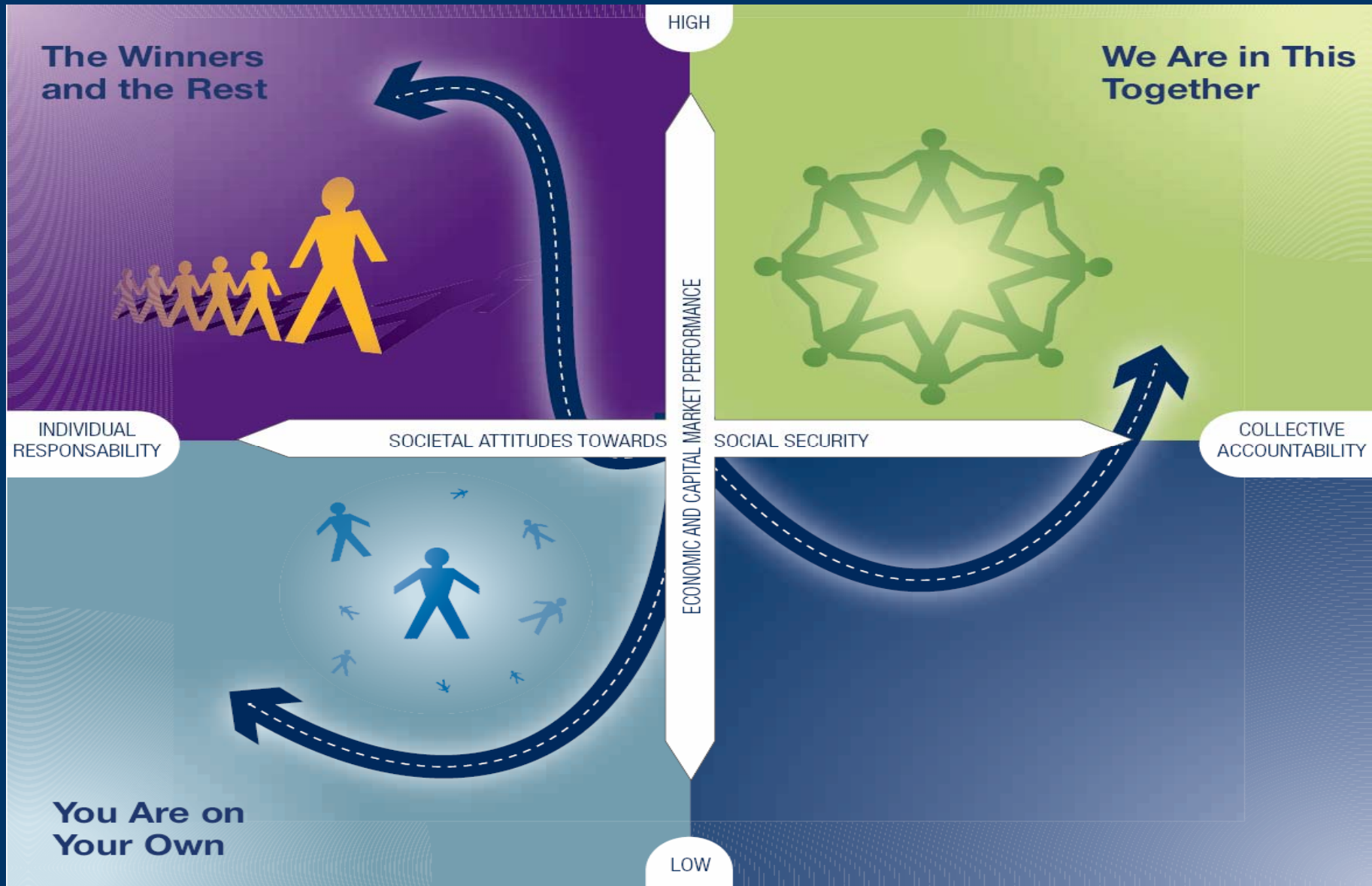


Key questions:

“How may the future look like by taking the various key drivers and uncertainty into account?”

“What may be the role of governments, the private sectors and the individuals”?

Outcome gave three key scenarios



Key characteristics of the three scenarios



High global growth

Financial consequences of burden from ageing delayed

Governments maintain scaled-back social security

Under-investment in public sector

Growing inequality and disquiet

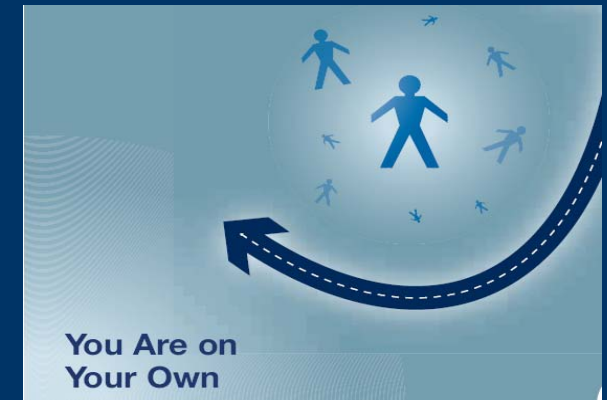


Medium global growth

Low capital returns offset by innovation

Leaders rein in inequality

Real collective responsibility



Prolonged economic recession

Fiscal difficulties for most state pension & healthcare funds

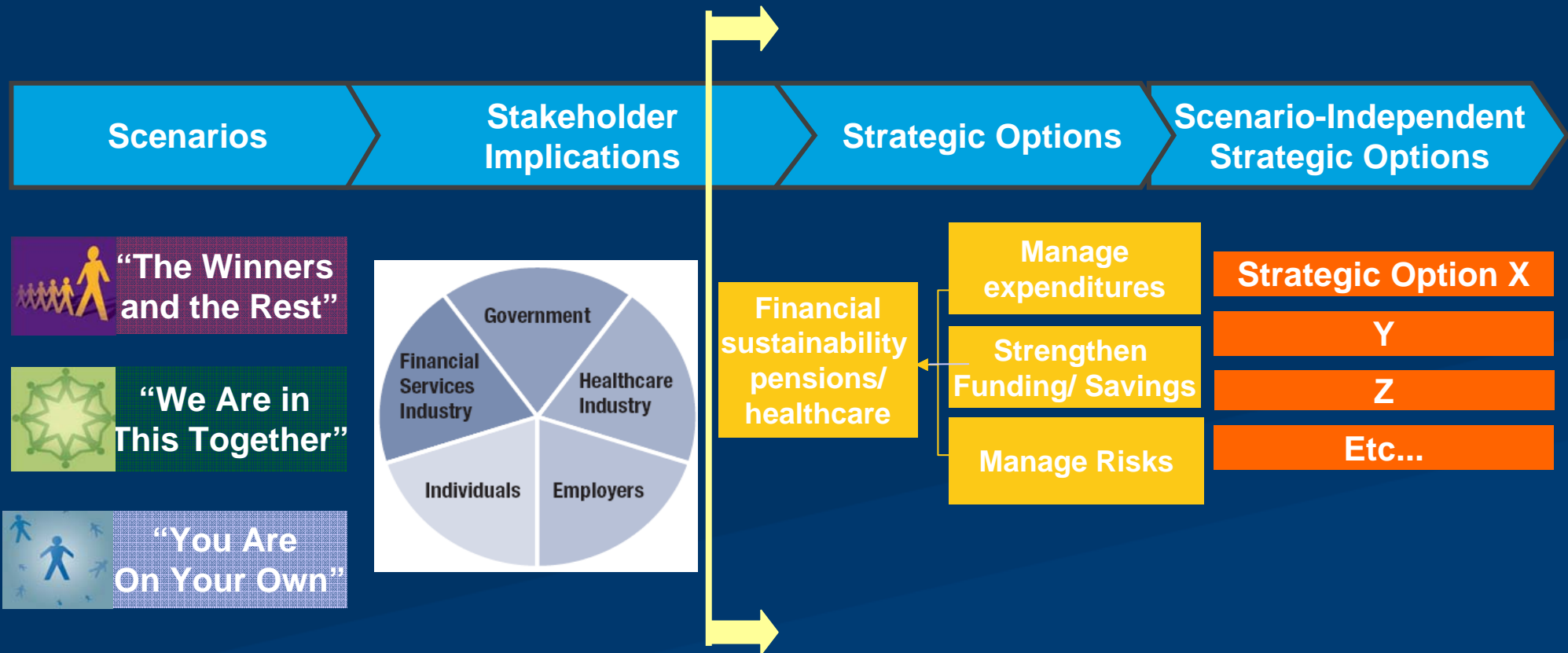
Individual responsibility forced on many

State-funded pension and healthcare reduced to minimum

Financing demographic shifts: Phase 2 strategic options

Phase 2 objective:

- Explore **new and less explored** strategies that will have a **large impact** socially, economically, and politically



Financial sustainability retirement provisioning

Manage expenditures

Fundamentally change the concept of retirement (“retiring retirement”)

Raise the official retirement age (in accordance with changes in life expectancy)

Lower operational costs public pensions through market competition / outsourcing

Enable retirement in a low-cost country

Strengthen funding / savings

Increase labor force participation of older workers and women

Improve financial awareness and education of individuals

Stimulate immigration of workers

Home equity release products

Encourage voluntary savings through “soft compulsion” (opt-out option)

Public Pension Reserve Funds

Manage risks

Develop and invest in longevity bonds

Macro swaps

Develop and invest in long-dated bonds (beyond 30 years)

Financial sustainability healthcare provisioning for the elderly

Manage costs

Strengthen funding

Promote healthy behavior / stronger focus on prevention

Stimulate informal care for the elderly

Automatic enrollment in healthcare plans with opt-out option

Integrated pensions and healthcare insurance products

Promote defined contribution healthcare plans

Further improve healthcare effectiveness

Strengthen social security funding by increasing labor force participation

Mandatory employer-sponsored healthcare insurance

Restrict healthcare insurance coverage (e.g. focusing more on the more expensive, unpredictable health risks)



Today's Agenda

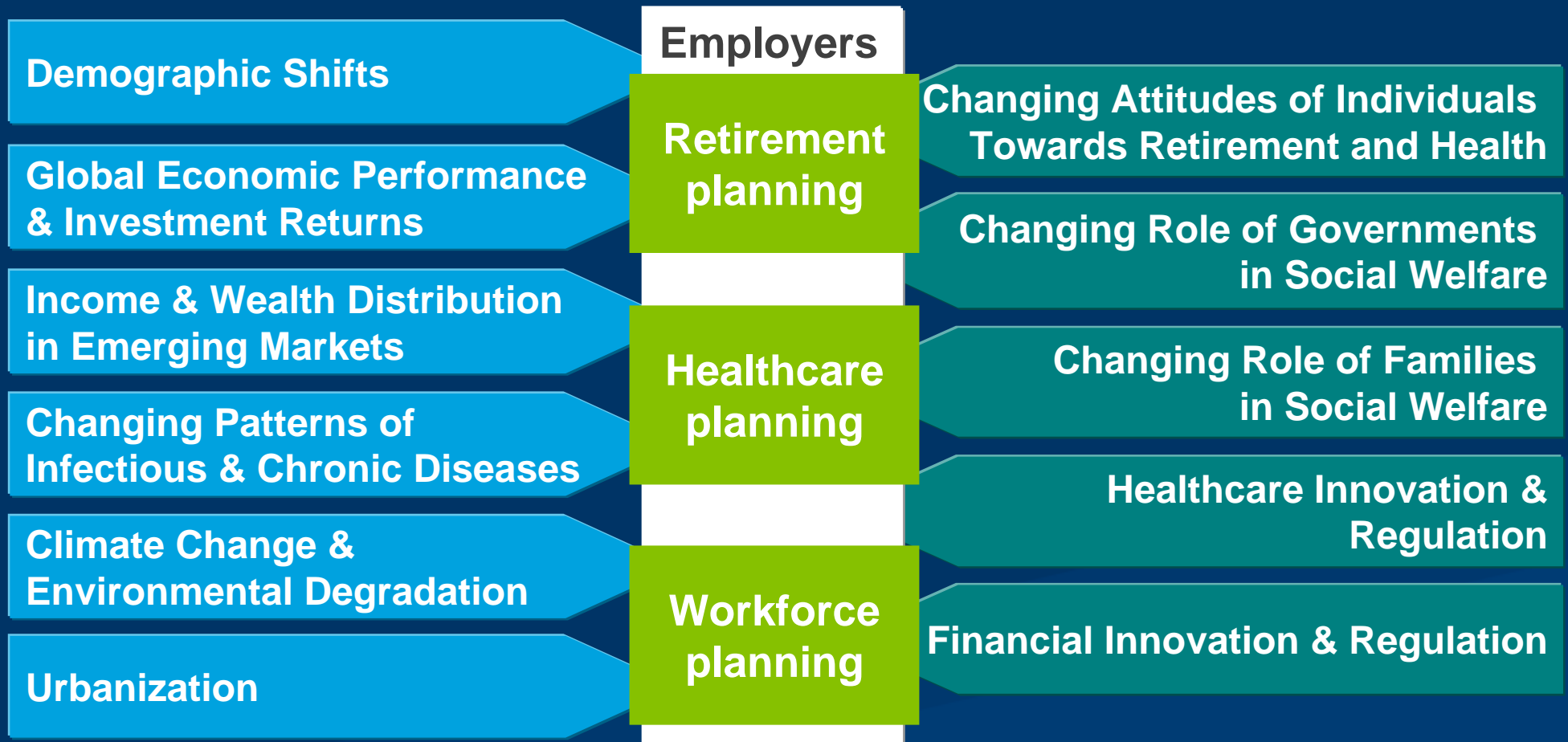
- The problem
- The process
- **The possibilities for employers**

Three key areas for employers

Overview of key driving forces impacting healthcare and retirement in 2030

Macro forces

Stakeholder forces



What employers should be watching for in retirement:

Changing attitudes of **individuals** to retirement

Changing role of **government** in social welfare

Changing role of **families** in social welfare

Current situation

- Length / nature of retirement
- Adequacy: “lost generation”
- Retirement plan: differentiator
- Employees not ready to take on risk

- Continuing pension reform
- Increasing retirement ages

- Shift from extended to nuclear families
- Hardening attitudes of young

Possible impacts

- Promote individual ownership
- Simplify retirement benefits
- Use as “A&R” tool
- Increase litigation risk
- Replace with lifestyle plans

- Enhance coverage
- Increase “collective plans”
- More governance, compliance, regulations
- Change workforce pattern

- Increase awareness
- Portability

What employers should be watching for in retirement:

Technology innovation and regulation

Financial innovation and regulation

Current situation

- Web-based access becomes the 'standard'
- Gap between providers in advanced and emerging geographies

- Shift from employers to employees (and DB to DC)
- Impact on FY 2008 financials
- Development of investment options and capital markets in emerging geographies

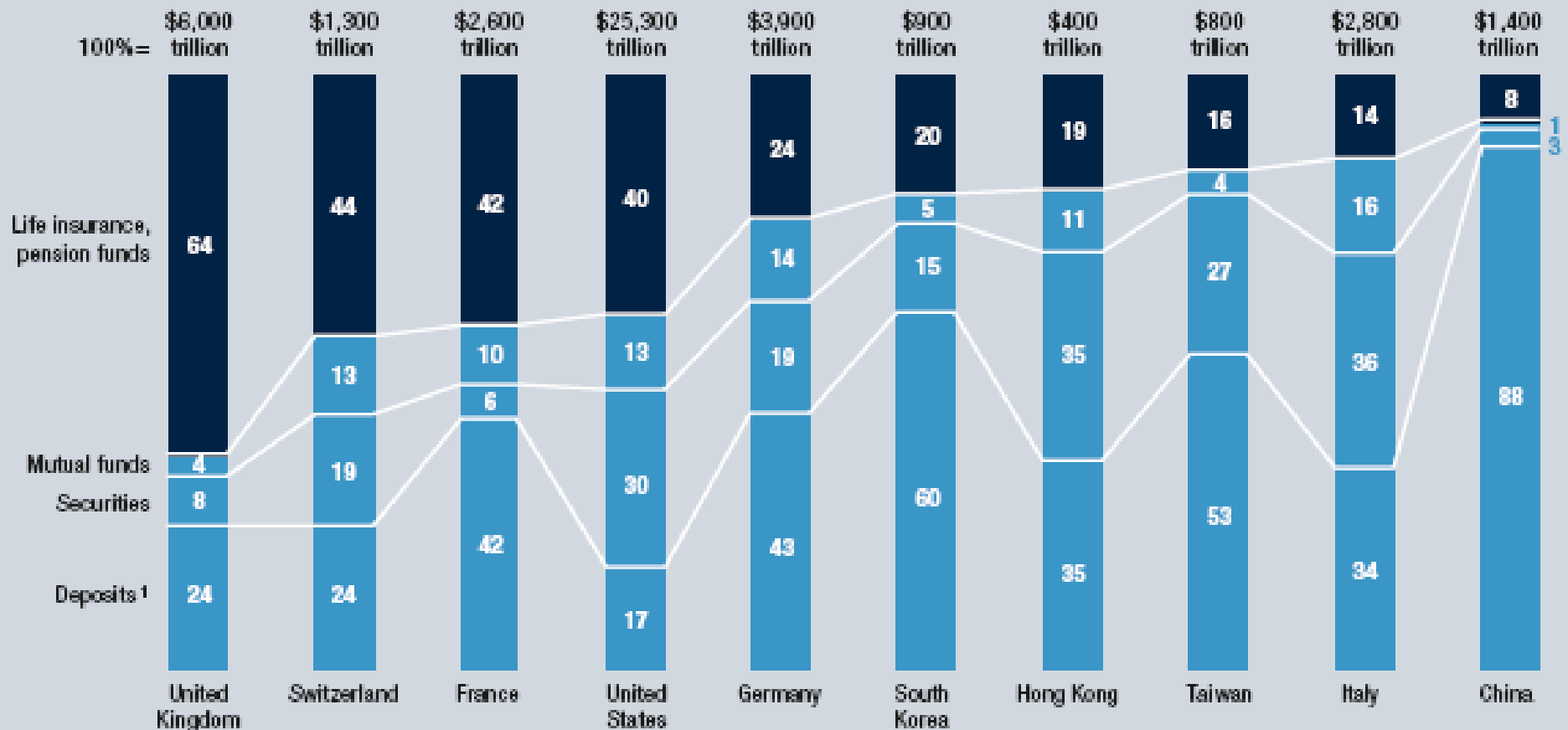
Possible impacts

- Increased popularity of employer portal
- Increased application of flex benefits

- Tight management for DB plans
- Shift philosophy on "adequate funding"
- Increased governance, trustee education
- Convergence of international standards
- Continued evolution in emerging markets

The vastly different retirement system and attitude towards risk and savings make retirement planning a highly localized arrangement

Figure 1.9 Distribution of personal financial assets, %



¹ Includes cash deposits

Source: McKinsey & Company, Inc. (1992-2008)

Future generations: less public pension

- **Since 1990...**

- nearly all 30 OECD countries have changed their pension systems

➤ average pension promise in 16 countries was cut by 22%

- **Pre- and Post-reform Gross Replacement Rates**

for workers on average earnings in selected OECD countries - % of individual earnings

	Men	
	Pre-reform	Post-reform
Austria	90.0	80.1
Finland	66.3	63.4
France	64.7	51.2
Germany	48.7	39.9
Hungary	57.7	76.9
Italy	90.0	67.9
Japan	40.7	34.4
Korea	69.3	66.8
Mexico	72.5	35.8
New Zealand	39.7	39.7
Poland	62.2	61.2
Portugal	90.1	54.1
Slovak Republic	59.5	56.7
Sweden	78.9	62.1
Turkey	107.6	72.5
United Kingdom	30.8	30.8

Source: OECD (2007)

Key issues facing governments - retirement

Developed economies

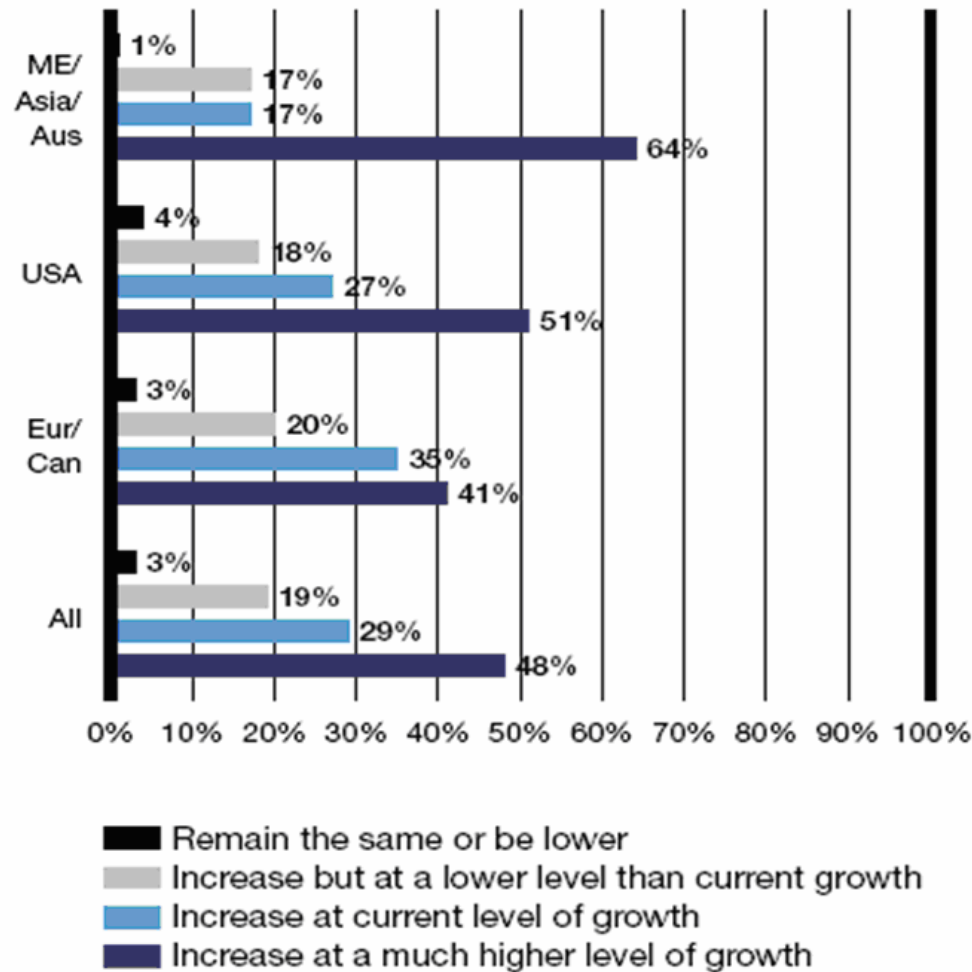
- **Financial sustainability** of social security systems
- Encouragement of **private plans** through tax relief
- **Regulations** on funding and accounting of private plans
- Benefit adequacy issues on the National DC Plan
- Increasing focus on post-retirement decumulation stage

Developing economies

- **Pension reforms**
 - Design of national policy and infrastructure
 - Expansion of coverage
- **Infrastructure issues** e.g.:
 - Basic capacity
 - Understaffing
 - Inter-department policy coordination
 - Capital market / investment options
- **Innovation on administration** of retirement benefit in rural population

Even without the longer term impacts, companies are already concerned about the impact of healthcare cost

FIGURE 3: How much do you expect health spending to increase in your country?



Source: PriceWaterHouse Coopers Health Research Institute: Health Cast 2020: Creating a Sustainable Future (2005)

Reasons for rising costs

- Medical technology advances
- Aging population
- Rising middle class
- Poorer health habits
- Chronic diseases
- Expensive drugs
- Government shifting cost to private sector

What employers should be watching for in healthcare:

Changing attitudes of individuals to health

Changing role of government in social welfare

Changing role of families in social welfare

Current situation

- Limited employee ownership
- Increased expectations:
 - Emerging middle class
 - Younger workforces
 - Quality of delivery

- Universal cost shift
- Reforms (funding /delivery)
- Legislation
- Governance

- Shift from extended to nuclear families
- Hardening attitudes of young
- Increasing burden on management of elderly

Possible impacts

- Promotion of individual ownership
- Avoidance provision
- Focus on health / wellness
- Understand litigation risks

- Invest in governance / compliance
- Prepare for social pressure (closing funding/ delivery gaps)
- Increase involvement

- Increase in costs due to chronic disease
- Pressure to redesign benefits
- New benefit to support elder care

What employers should be watching for in healthcare:

Healthcare innovation and regulation

Financial innovation and regulation

Current situation

- Treatment cost increases continue
- Drug availabilities vary by geography
- Insurers limiting liabilities

- Slowing growth in emerging economies
- 'Fall-out' from credit crunch
- Unknown impact on healthcare
- Innovations in pan-border funding

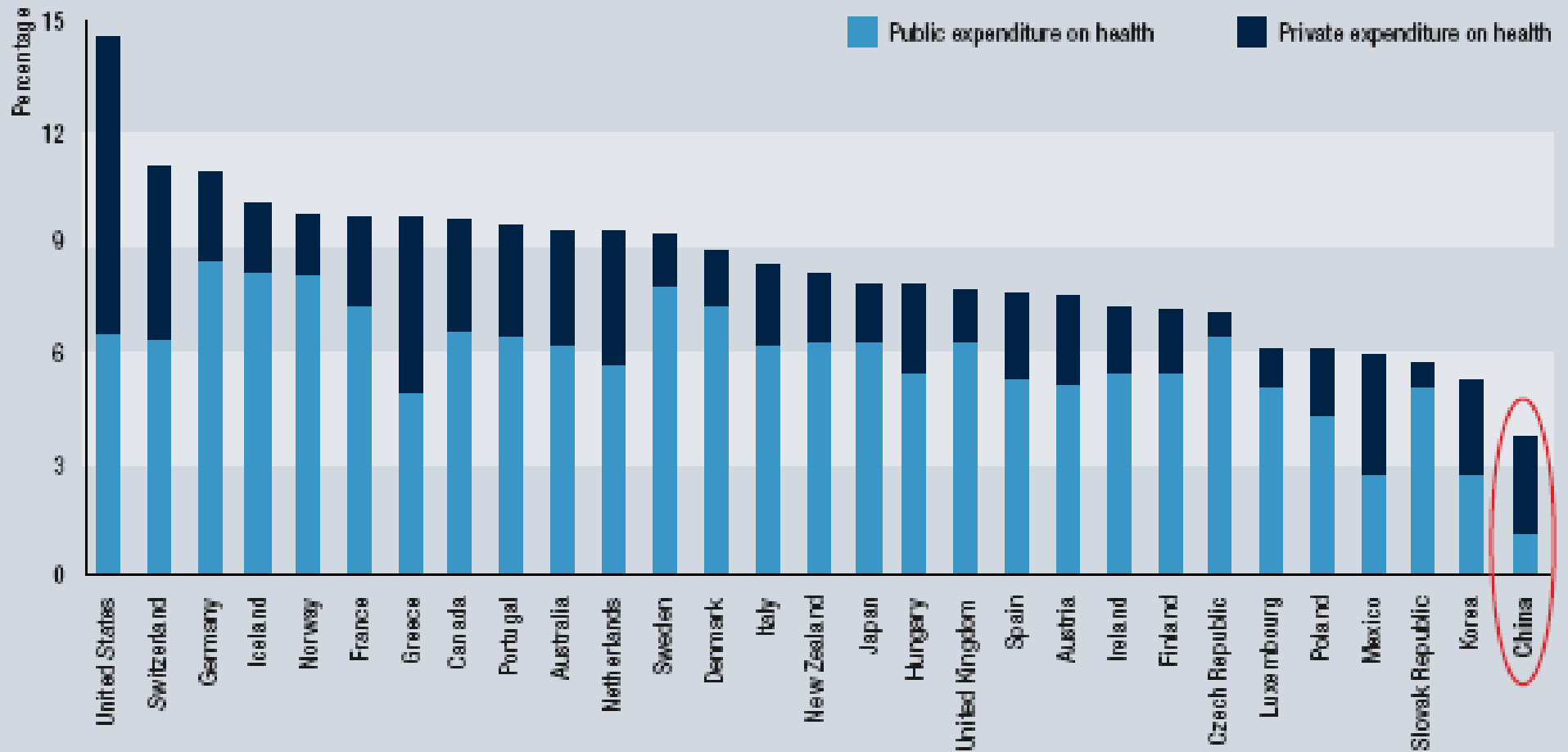
Possible impacts

- Regular new decisions about treatment inclusions (ROI)
- Access to care / Rx alters return to work expectations
- Global purchasing leveraged
- Lobbying required

- Pressure doesn't change cost shift
- Limitations placed on benefits
- New pan-border insurance products and self-insurance opportunities

The vastly different starting points in funding mechanisms and delivery architectures make it a complex area

Figure 1.10 Public and private health spending as % of GDP in selected countries



Source: OECD (2008)

Key issues facing Governments - healthcare

Developed economies

- Provision of care for the elderly
- Reducing inequalities
- Releasing funding for prevention
- Increasing unit treatment costs/eliminating waste
- Increasing mental health burdens
- Effective use of capacity
- Access mechanisms

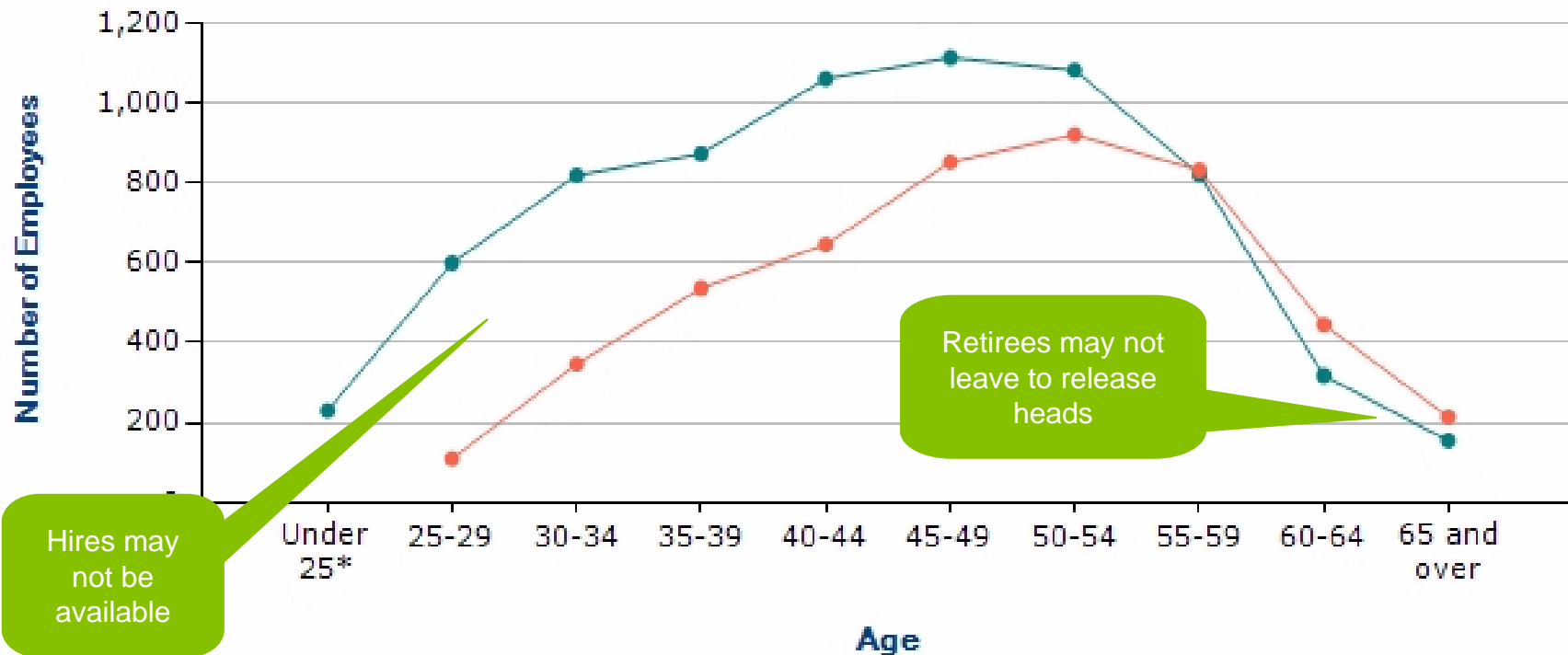
Developing economies

- Infrastructure issues e.g.:
 - Basic capacity
 - Understaffing
 - Eligibility tracking
 - Claims data framework and analytics
- Eliminating infectious disease burdens
- Increase in lifestyle diseases
- Dissatisfaction with access
- Poverty as driver of poor health and prioritising health over other social spends

Working through the impacts of the changing demographic will be critical

Actives No New Hires Age Projection : All Data

[View in Popup](#)

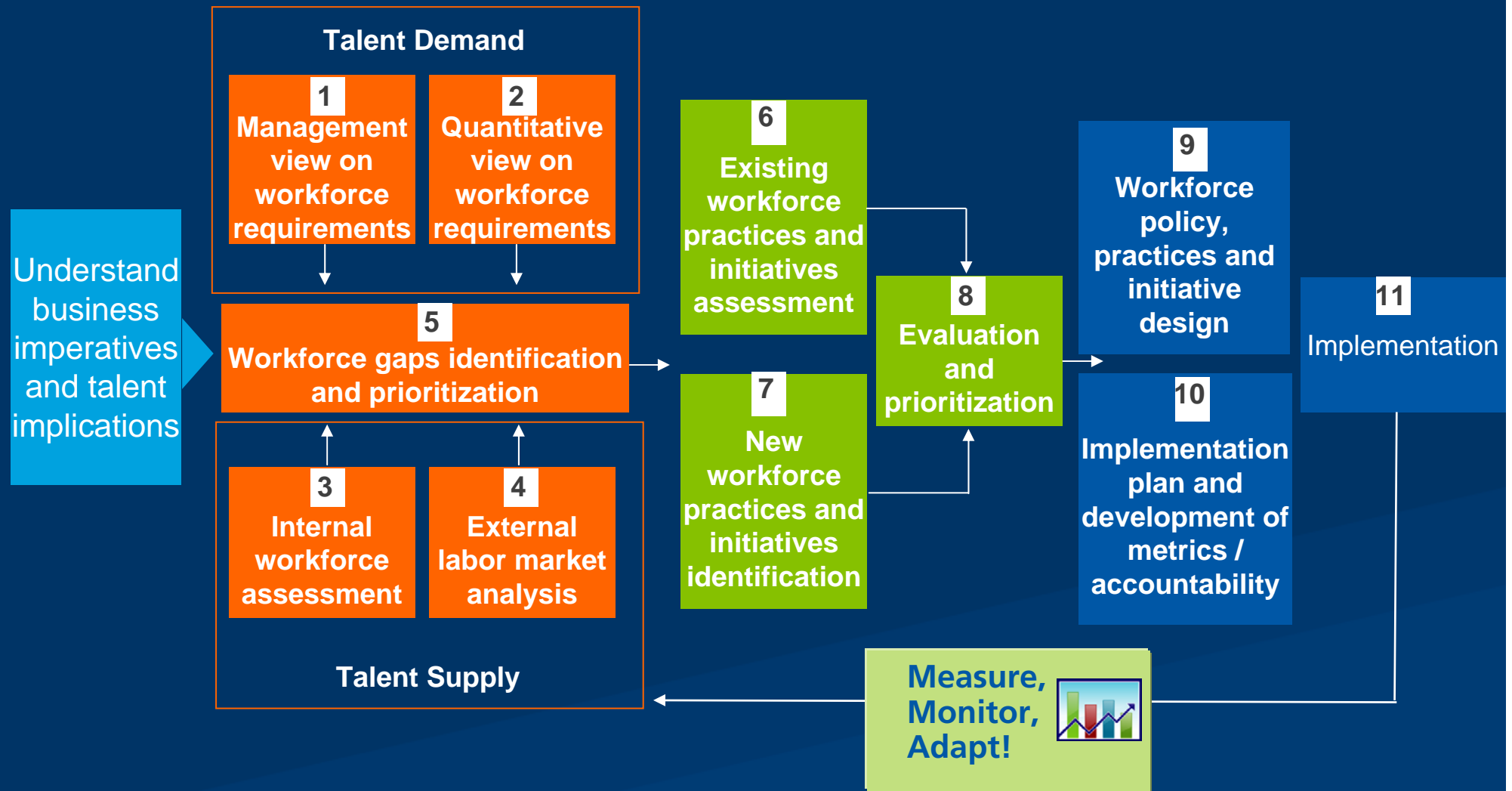


Hires may not be available

Retirees may not leave to release heads

Year	Average Age	Total Employees
2010	49.1	4,899
2005	44.2	7,063

The following map provides a top-level illustration of how the various process steps flow and connect



Thoughts on retirement plans in China

Challenges

- Market experience is limited
- Still ambiguity and inconsistency regarding taxation regulations
- Investment choices are limited
- Lack of understandings by both companies and employees
- Unclear as to include foreign nationals in the retirement plans

However, with...

- > 20% of the population >65 by 2040...
- Replacement ratios for social security very low...
- The proportion of pension assets to GDP being low...
- > 30% of leading companies having an SPP (sponsored pension plan)
 - With Enterprise Annuity still expected to be 'mainstream' pension plan

**Company-sponsored
pension plans will become
more prevalent**

Thoughts on healthcare in China

Challenges

- Total spend per head is very low
- Significant urban/rural divide
- Infrastructure availability is mixed
- Networks are in their infancy
- Basics of eligibility tracking and record keeping are troublesome
- Little or no claims data is available
- Infectious diseases remain a burden; lifestyle diseases likely to increase

However, with...

- The Chinese middle class growing...
- Regional institutions seeking changes...
- Increasing investment in delivery...
- Early innovations in plan designs including expats; an opportunity to leapfrog traditional solutions...
- A focus on quality of delivery...
- POEs and SOEs competing for global talent
- More MNCs using China as a regional hub

Companies will be able to have a significant impact on their employees health

A blurred background image showing three people in professional attire. A woman in the center is smiling and looking towards the left. Two men are visible on either side of her, also in professional clothing. The background is out of focus, suggesting an office or meeting environment.

Questions?

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What employers should be watching for in healthcare:

Changing attitudes of individuals to health

Current situation

Limited ownership for health by employers:

- State responsibility
- Inability to influence:
 - Health status
 - Lifestyle diseases
- Medical confidentiality

Increasing expectations of:

- Emerging middle class
- Younger workforces
- Quality of delivery

Possible impacts

Promotion of **individual ownership** of health

- Education and behaviour change
- Rapid access to appropriate care

Avoiding provision

Attraction programmes focused on health and wellness benefits

Increase in **risk of litigation** over health

What employers should be watching for in healthcare:

Current situation

Possible impacts

Changing role of Government in Social Welfare

Universal cost shift from governments

Reforms focused on **funding effectiveness and delivery** - less on outcomes

Increasing legislation and governance in emerging geographies

Investment in **governance and compliance**

Social pressure and demand to **close funding/delivery gaps**

Increasing involvement in health and care

Changing role of families in Social Welfare

Shift from extended to nuclear families

Attitudes of young **hardening** on expectations

Increasing burden on management of elderly

Increase in costs for extended families due to chronic disease

Pressure to redesign benefits

New benefit developments to support elder care

What employers should be watching for in healthcare:

Current situation

Possible impacts

Healthcare innovation and regulation

Treatment cost increases continue

Drug availabilities variable
by geography

Insurers limiting liabilities
where they can

Regular new decisions about **treatment inclusions – ROI**

Access to care / Rx, **alters return to work expectations**

Opportunities to **leverage global purchasing**

Lobbying required to address regulatory and tax advantages

Financial innovation and regulation

Slowing growth in emerging economies

Current **'fall-out' from credit crunch**

Unknown impact yet on healthcare

Innovations in **pan-border funding options**

Pressure doesn't change on cost shift

Limitations on benefits

New **pan-border insurance products** and self-insurance opportunities

What employers should be watching for in retirement:

Current situation

Changing attitudes of individuals to retirement

Possible impacts

Promotion of **individual ownership** of retirement savings

- Education and behaviour change
- Access to financial education
- More regulations

Simpler retirement benefits, with default options

Retirement plan as **attraction and retention tool**

Increase in **risk of litigation** from retirement plans

Replacement of retirement with **lifestyle planning** and funding

What employers should be watching for in retirement:

Current situation

Possible impacts

Changing role of Government in Social Welfare

Continuing pension reform

- responsibility shift
- more governance on corporate plans
- Encouragement on voluntary savings plans
- Ever changing tax relief

Increasing retirement ages

Pressure to **increase retirement coverage** and benefit redesign

Increase in

- “collective plan” and international plans
- governance and compliance
- regulations to prevent savings leakage and to safeguard distribution

Change of **workforce pattern**

Changing role of families in Social Welfare

Shift from extended to nuclear families

Attitudes of young **hardening** on expectations

Increased **awareness** of retirement savings & financial planning

Portability is important

What employers should be watching for in retirement:

Current situation

Possible impacts

Technology innovation and regulation

- Web-based access becomes the 'standard'
- Gap between providers in advanced and emerging geographies

- Employer portal increasingly popular
- Increased application of flexible benefits

Financial innovation and regulation

- Continuing shift of retirement responsibility and risk from employers to employees (DB to DC)
- Significant impact on 2008 year-end financials
- Continuing development in the capital markets and investment options in emerging geographies

- Tight accounting and valuation management for DB plans
- Shifting philosophy on "adequate funding" of the retirement plans
- Increased governance process and increased trustee education
- Convergence of international standard on accounting and funding
- Evolution of investment options in emerging markets