

11th Annual Superannuation Colloquium: Retirement Provision in Scary Markets, July 2003

Background

The theme for the 11th colloquium is **Retirement Provision in Scary Markets**. Saving for retirement is saving for the long term. In the era of compulsory retirement saving, individuals will accumulate retirement savings over the 30-40 years of their working life, and are likely to decumulate these assets over a further 20-30 years. Both academics and practitioners alike advocate a diversified portfolio of assets with differing risk and return attributes, with asset mix determined by a variety of factors including risk preference, age, wealth and government policies (such as taxation, regulation and public age pension means test requirements). Less clear, however, is how to organise retirement saving and investments in times of heightened uncertainty. This is central to the theme of the 11th colloquium.

As an innovation for 2003, the first day of the colloquium (Monday 7th July) comprises one day of invited papers from distinguished international and domestic speakers on the conference theme of **Retirement Provision in Scary Markets**. The second day (Tuesday 8th July) is dedicated to contributed papers.

Invited Speakers

Ron Bewley (Commonwealth Bank)

Geoffrey Brianton (Merrill Lynch Investment Managers)

Jeremy Duffield (Vanguard Investments Australia)

Olivia Mitchell (Wharton)

Mike Orszag (WatsonWyatt, UK)

Flavio Rabelo (Escola de Administração de Empresas de São Paulo)

Susan Thorp and Geoffrey Kingston (UNSW)

Masaharu Usuki (NLI Research Institute)

Program

Monday 7th July

8.45 am - 9.30 am

Registration and Coffee:

Mathews Theatre C The University of New South Wales

9.30am – 5.30pm

Invited papers

Who's afraid of the big bad bear? Or why investing in equities for retirement isn't scary and why investing without equities is even scarier

Ron Bewley (Commonwealth Bank of Australia)

Assessing the risks in global fixed interest portfolios

Geoffrey Brianton (Merrill Lynch Investment Managers)

Lessons in member investment choice

Jeremy Duffield (Vanguard Investments Australia) and Pat Burke (Plum Financial Services Ltd)

Earnings variability and retirement shortfalls

Olivia Mitchell (Wharton), John Phillips and Andrew Au

How scared are older workers by scary markets?

Mike Orszag (WatsonWyatt, UK)

Private pension provision in a developing country: the case of Brazil

Flavio Rabelo (Escola de Administração de Empresas de São Paulo)

Financial engineering for Australian annuitants

Susan Thorp and Geoffrey Kingston (UNSW)

Japanese pension plans in depressed economy: pension plan countermeasures and their policy implications

Masaharu Usuki (NLI Research Institute)

6.30pm - 7.00pm

Pre Dinner Drinks

7.00pm

Colloquium Dinner

Tuesday 8th July

9.00am - 10.30am

Presentation of contributed papers

10.30am - 11.00am

Morning Tea - Pavillion West Wing

11.00am - 12.30pm

Presentation of contributed papers

12.30pm - 1.30pm

Lunch - Pavillion West Wing

1.30pm - 3.00pm

Presentation of contributed papers

3.00pm - 3.30pm

Afternoon Tea - Pavillion West Wing

3.30pm - 5.00pm

Presentation of contributed papers - Closing remarks

Abstracts

Who's afraid of the big bad bear?

Or why investing in equities for retirement isn't scary and why investing without equities is even scarier

Ron Bewley (Commonwealth Bank)

The third millennium bear market has caused financial worries to many especially those about to retire and those exposed to equities in retirement. The natural reaction is for investors to avoid or down-weight equities in their portfolios, at least until this bear market becomes a distant memory. Recent negative returns have depleted savings for anyone in equities. Of these investors, those drawing on an allocated pension, without sufficient cash reserves to weather the bear market, have been hit the hardest.

While some alarmists are prophesying the-end-of-the-world-as-we-know-it, there are good reasons for believing that a return to normalcy will come. In such a world, good planning, with the aid of a sensible quantitative asset allocation model provides risks and returns that outstrip those who chose to avoid equities.

The current market is put into perspective using a statistical analysis of equity returns and asset allocations. The potential of the future market is defended.

The need for a dynamic asset allocation over an investor's life cycle is discussed. Emphasis is placed on the distinction between investing while working and investing during retirement. The importance of an adequate allocation in cash and other low risk liquid assets is stressed.

Our prescription for investing in equities is evaluated in a simulation experiment. We do this in the context of the expected duration of future bear

Assessing the risks in global fixed interest portfolios

Geoffrey Brianton (Merrill Lynch Investment Managers)

Abstract

The number of risks in typical fixed interest portfolios has increased over the last decade. There has been a shift from being invested predominantly in domestic and government issued securities to portfolios that have a global spread of investments and an increasing reliance on credit. This has occurred against a backdrop of a shift to more integrated capital markets, a move to a low inflation global economy and a withdrawal from the debt markets by many government issuers.

Duration and convexity measures are no longer sufficient to measure and control risk in portfolios that contain exposure to a number of yield curves, currency risk and credit risk.

Portfolio specialists will have a good understanding of the risks in their own field. For example, one specialist will understand the credit risk of a 10-year sub-investment grade security; another will understand the risks of having a one-year duration position in the Euro. However, the net effect of both these positions within a portfolio is not obvious. This raises two problems; ensuring the overall risk of the portfolio is appropriate and that risk taken in each area is consistent with the potential to add value. These problems are compounded when the expertise required to manage a global bond portfolio is distributed around the world.

Lessons in member investment choice

Jeremy Duffield (Vanguard Investments Australia) and Pat Burke (Plum Financial Services Ltd)

Abstract

The Australian superannuation model has moved at rapid pace to a system in which individual members are increasingly responsible for the investment of their own superannuation savings. Australia thus follows the long-established trend in the 401k market in the United States where participants typically select from a substantial number of mutual fund options to invest their retirement savings.

This paper addresses the experience of member investment choice in both countries, covering how investors have responded in a bear market environment in the recent period. This difficult backdrop allows us to evaluate the likely success of members in achieving their retirement objectives in a self-provisioning regime, and to learn what programs are most likely to foster member success. The role of member education, financial advice and default options are all considered. Further, the paper argues the case that indexed investment programs should be a core part of member investment choice programs.

Earnings variability and retirement shortfalls

Olivia S Mitchell (Wharton), John Phillips and Andrew Au

Abstract

How scared are older workers by scary markets?

Mike Orszag (WatsonWyatt, UK)

Abstract

The decline in equity markets in the past few years is an excellent natural experiment to assess how individuals near retirement adjust their retirement expectations, labour supply and risk bearing in the face of adverse equity market conditions. This paper will present new survey evidence on how individuals aged 55-70 have responded in the United Kingdom. We look at which individuals have changed their retirement plans as a result of decline in equity markets and whether these results are consistent with theories such as Bodie, Merton and Samuelson (1988) about lifecycle asset allocation and work decisions. We compare these results with available evidence for other countries including the United States and Australia.

Private pension provision in a developing country: the case of Brazil

Flavio Rabelo (Escola de Administração de Empresas de São Paulo)

Abstract

The paper will provide an overview of the private pensions industry in Brazil, establishing some comparisons with the US, the U.K. and other Latin American countries. It will also emphasize regulatory aspects of the private pensions industry.

Financial engineering for Australian annuitants

Susan Thorp and Geoffrey Kingston (UNSW)

Abstract

Financial engineering uses modern contingent claims analysis to value securities and identify financial strategies. This paper applies financial engineering techniques to a number of problems faced by annuitants in Australia. Issues include the adequacy of existing pension valuation factors for women with allocated pensions, the use of endowment warrants in portfolio insurance strategies for annuitants, the sale of call options to safeguard social security entitlements and tax benefits, and the implementation of delay-option strategies, using allocated pensions, in order to manage longevity risk.

Japanese pension plans in depressed economy: pension plans countermeasures and their policy implications

Masaharu Usuki (NLI Research Institute)

Abstract

Japanese retirement benefit plans have been struggling in the last 12 years of depressed profitability and stock markets. The objective of this paper is to describe the difficult situation the Japanese government had to face during this struggle and policies they actually took to cope with this. I will be glad if this paper could lead to any meaningful implications, which are applicable to other countries in the midst of continuing bad economic conditions.

The first part, describes the government's plight by citing stock and other asset returns, financial conditions disclosed under new accounting rules and plan sponsors declining profitability. The following part explains what countermeasures pension plans and their sponsors have taken for these stagnant business conditions. At first, attempts were made to overcome pension plan problems by improving asset management, partly because investment management was heavily regulated by legal list until late 1990s. The emphasis on asset management, however, did not bear fruit. As stock prices declined further, rates of return plummeted. After the two-year technology stocks bubble, the stock market index continued to decline, resulting in three straight years of negative return since 2000.