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RETIREMENT SAVINGS:

WHAT CAN THE U.S. LEARN FROM AUSTRALIA AND ASIA?

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P R O C E E D I N G S

MR. GALE: Good afternoon. We're actually going to try to start on time here and stick to our schedule. I'd like to welcome you to the Brookings Institution. Today's event on retirement savings, "What Can the U.S. Learn from Australia and Asia?" My name is Bill Gale. I'm a senior fellow here. I'm head of the Retirement Security Project, or RSP. RSP is proud to be co-hosting today's event with AARP's Public Policy Institute.

In light of the need of reform to the Social Security system and in light of the strengths and shortcomings of our own retirement system, RSP and AARP thought it would be helpful to look at what other countries are doing, why they are doing it, how they've done it, how effective it's been and so on. Of course, we don't want to necessarily mimic what other countries do simply because they did it, but likewise, we certainly don't want to ignore what other countries have done and learned. So, we see this as an opportunity for all of us to learn more about what's happened in other countries as well as a source of input in thinking about what the United States should do.

Having said that, let me also say that I really like short introductions, so I'm going to stop here and turn the mike over to Gary Koenig. Gary is the head of economic security in AARP's Public Policy Institute. And let me say that I'm delighted that RSP is co-hosting the event with him and with AARP. So, over to you.

MR. KOENIG: Thank you, Bill. I want to thank David John and Bill Gale for organizing this event. I think the large turnout reflects the quality of today's program, but it also shows the interest in U.S. pension reform.

The word "pension" is probably not the right word, because really,

what we're talking about is the U.S. retirement savings system, a/k/a the 401K system. Traditional pensions for current private sector workers, unfortunately, are largely a thing of the past. I'll also say that "reform" may not be the right word, either. Perhaps we're talking more about significant tinkering. Maybe that would be a better phrase.

But we do need changes. The current year's retirement savings system is not working well enough for enough workers. So let me say that again and emphasize that. It's not working well enough for enough workers. So, that is not to say the system is not working well for some. It is. We know it is. That is also not to say that I think it has to work well for everyone. We may get better results for the really low income by improving Social Security or even reforming the supplemental security income program. But when the Employee Benefit Research Institute estimates that the savings gap is $4.3 trillion, we know we have a problem. We know we need to do better.

The areas for potential improvement include greater access to a workplace savings plan. The number without access to a workplace savings plan is in the tens of millions, regardless of how we measure it. We also need greater savings among those who have access. We need more effective incentives for employers and workers to offer and participate in plans, and we need greater protection from market and longevity risk.

So, why should we look at what other countries are doing? Well, because retirement savings is an international problem. Inadequate retirement savings is an international problem, and many countries are implementing reforms. In the UK just last week, the government released a report saying that even with its pending reforms, millions will still face reduction in the standard of

living once they reach retirement. So, how we address the problem of inadequate savings is key.

The worldwide debate centers on which approach: Required savings like Australia or auto-enrollment such as that used here, build savings best. Equally important is which approach is most politically feasible. Now, one thing to keep in mind as we hear the speakers and panelists is that while we all share a common problem, each country faces its own political and financial history. So while we can learn from other countries and they from us, it is not going to be as simple as transplanting the country's successful system one place or another. Elements may transfer, but they will have to be adapted to each country's specific circumstances.

So, before I leave, let me just tell you a little bit about AARP's Political Policy Institute. The institute is responsible for analyzing and developing policies for AARP on a wide range of issues related to the economic and health security of older Americans. We think lack of savings is a key issue facing future retirees, which is why I applaud David and Bill for putting this together, and I hope we will have others like this to look at other systems such as the UK and New Zealand. David?

MR. JOHN: All right. I'm David John. I'm a senior strategic policy advisor with the Public Policy Institute, and I'm also the deputy director of the Retirement Security Project. A word on how we're going to organize this afternoon. First, we're going to have two individual speakers. Nick will speak first, and then Joseph. Following that, we will have a panel of three respondents and then, all of them are going to get up front and have a little discussion amongst themselves, but also, respond to questions. So, jot them as we go

along.

Our first speaker is the Honorable Nick Sherry, who was an Australian senator from 1990 to 2012 representing Tasmania. He chaired the Senate Committee on Superannuation, and in that role, he supervised and oversaw legislation that basically created the superannuation system that we're going to be looking at today.

In 2007, he became the first minister of superannuation, and initiated a variety of reforms, the like of which I'm sure he'll cover today. He also introduced single national regulation for all financial providers, products and advisors in Australia as a part of his role, and he was a member of the cabinet subcommittee overseeing the financial crisis, which he assures me was not his fault. But it was his doing that Australia came out as well as they did.

Following that, in 2008, he was appointed as the assistant treasurer and introduced a new national accounting and tax advice oversight and a variety of other reforms. So without further ado, Nick. (Applause)

MR. SHERRY: Well good afternoon. Thanks very much, David, for the kind introduction. It's good to be back here in the States. If I sound a little jaded, this is the fifth country of a seven-country tour over the last two weeks, and I'm ending up in Greece. And if you really think you've got problems here (Laughter) -- But I'm not going to Greece today. Ernst & Young, who I do some advisory work for now, have the great challenge of redesigning the entire Greek pension system. It's certainly the greatest personal challenge of my long career.

But thanks for the introduction, David. David John and I go back a long, long way, so it's been a great pleasure to interact with David. Thanks to Brookings, AARP and good to see my old friend David Harris, as well, another

Australian. But anyway, since I retired, even during my long political career, I spent a great deal of time specializing in pension systems design and their operation, and I'll go through some issues relating to Australia to illustrate.

But I've spent a lot of years looking at pension systems design, and I would endorse the comments made earlier about every country is going to have to deal with the issues, and now adapt to their local, economic, social and political circumstances. That's inevitable. But the key challenge that I think every country in the world faces at the moment -- and I'm not just talking about advanced economies -- Josef, from an Asian perspective will talk about emerging economies. There are remarkable similarities in the issues that we face around retirement income systems.

I thought this afternoon, very briefly, an overview of the key reforms in Australia and why they were made, and then, some useful lessons, I think, that can be drawn from the reforms. And I would emphasize that the outline I'm giving is a very, very simple part of what was a very lengthy and complex story, but at the time, obviously, I'm just focusing on the major reforms. And I also would emphasize that mistakes were made, not by me, of course (Laughter). But there were mistakes made along the way that are useful to learn from. And with that, I'll just touch on the major reforms.

Australia is a relatively unusual advanced economy from a demographic point of view, and is not perhaps, facing the same size challenges that many other advanced economies have. So, Australia's population is 23 million, but it's forecast to rise to between 38 and 44 million in 2015. Australia has always had a relatively low basic state pension at pillar one compared to other advanced economies. We now have a mandatory, I'll use that horribly dirty

word, compulsion -- not a dirty word in Australia -- a compulsory defined contribution system at pillar two.

The other point to make about Australia, though, is that despite a growing population, it is an aging population. Twelve percent over 65, forecast to be 22 percent in 2050. I suppose one of the great lessons from Australia is despite not having the size of challenge that most other advanced economies face, Australia, nonetheless, embarked 30 years ago on what I think you would describe as a radical program of reform to its retirement income system.

So, to deal with the key reforms, in the 1980s, the Australia pension system, universal flat basic state pension, about 24 percent of average earnings at age 60 for women, 65 for men. Pillar 2 was defined benefit. Three out of ten in the workforce mainly covering the public sector and large corporations.

Over a period of the last 30 years, there were some key major reforms made. In 1983, the basic state pension was indexed to 25 percent of male total average weekly earnings. So, an automatic escalator was added to the basic state pension. In 1994, perhaps the most controversial of all the Australia reforms and the most difficult politically, even more difficult than compulsion at pillar two, was the introduction of a means test -- an assets and incomes means test which basically removes about 20 percent of Australian retirees -- higher income retirees -- from any state benefit whatsoever. And another 20, 25 percent receive a part state pension. That was an enormously controversial and bitterly opposed policy change.

In 1995, we commenced the increase of the female pension age to 65, and that was achieved just last year. And in 2010, we improved the basic

state pension by increasing its indexation to 27.7 percent of male total average weekly earnings. And we also made the decision to increase the pension age to 67 by 2023.

Now, the reforms at pillar two, probably the most interesting -- in 1987, we commenced with a compulsory defined contribution of three percent. Three percent. In 1992, that 3 percent over a period of ten years was increased from 3 to 9 percent defined contribution. And last year, legislation was passed to increase the 9 percent to 12 percent. It's commenced that increase by 2020.

I'd also mention, and something that's often missed in the Australia system, on top of the mandatory contributions, there is currently an average voluntary employee contribution of between 3 and 3 ½ percent. So we have a total DC contribution at the moment of about 12, 12 ½ percent.

From 1990 to 2005, most defined benefit schemes in Australia were closed to new entrants. So, the promise was kept. The future promise was kept for the current members of DB, and that includes both public sector and the private sector. There are four open DBs left in Australia -- one covering the military, one covering judges, and two others I found in the last year in my commercial lot. I did try to close the military DB and the judges, but unfortunately, they had guns and could send me to jail, (Laughter). So that was just one step I couldn't accomplish. But DB is largely dead in Australia.

In 1994, Australia's regulatory oversight, governance oversight was derived from UK common trust law. In 1994, having created a mandatory system, we decided to codify that law and improve it, because when you create a compulsory system, the duty of care to government enforcing people to part of a DC system requires an overhaul of the governance rule. So there were

significant improvements around the prudential regulation of funds and the way they operated. And there have been a succession of regulatory of upgrades of funds, their management and investment requirements in Australia over the last 15 years.

What were the reasons for reform? I identify a couple of key reasons. The first and most fundamental reason advanced for compulsory DC in Australia was actually fairness. The policy objective was to increase the retirement income for all Australians, but particularly the 7 out of 10 who had no benefit at pillar two. And that's accomplished by a DC system where your DC account grows over time. So it was fundamentally a fairness argument. The Australian system, like many around the world, was unfair. You had a very basic state benefit, and those who tended to be higher paid with senior executive positions moving through a career structure with the beneficiaries of defined benefit at pillar two, which was also significantly tax advantaged. So it was a fairness argument.

The second main reason was sustainability. There are a number of issues we've dealt with in the context of sustainability. Means testing is one of them. That is a very, very significant saver to the budget of the cost of the state pension.

The third principle is compulsion or mandation. If you want to ensure maximum coverage, voluntary incentives simply do not suffice. They do not suffice. I note with interest countries like the UK, where I am doing a lot of, or have done a lot of work, have done a sort of softer version. It's an opt-out auto enrollment, but you can opt out version. Typical Brits. You know? They sent us all to Australia on a compulsory convict relocation (Laughter), and they can't deal

with compulsion themselves.

But anyway, the fourth reason, which didn't have a lot of currency in the early days but has become particularly important is the economic. The Australian system is now the fourth largest in the world for a country of 23 million people. It was 1.6 trillion Australian dollars in assets. It is larger than the size of the Australian economy. It has a very, very significant, positive economic and savings impact, and it's particularly profound.

Little studied, little analyzed. One of the reasons why Australia did particularly well in the financial crisis was having a long-term savings pool of this nature, very, very important for our economy. And the size of the system is projected to double to three trillion Australian dollars in 10 years, and then double again to six to seven trillion dollars. I mean, this is a massive global system for a country of 23 million people.

Very briefly, attitudes to reform -- as I've mentioned, the means testing of the state pension was deeply unpopular, bitterly opposed. I recall the debates, but interestingly was not reversed by successive governments who opposed it -- then opposition. It has not been reversed. In fact, it's been extended more gradually by broadening it.

A compulsion was opposed, not perhaps as vigorously as the means testing provisions, and all of the research that we did at the time -- obviously, as a former politician, I'm deeply concerned about public attitudes. At the time of the debate on compulsory DC in Australia, about 50 percent public support. But interestingly, within six months, that had risen to 85 percent public support. And the key reason for that was members receiving their personal statement after their initial contribution. So, it might have been a very modest

few hundred dollars, but as soon as they received their personal statement with some level of savings that they would never have had, support to 80, 85 percent and it's never dropped below 80 percent, even in the financial crisis when accounts went backwards.

Very, very briefly, just to highlight what I think are important lessons to learn -- also, the other issue, the closure of defined benefits was not controversial in Australia. And it somewhat bemuses me, frankly, when I see the controversy around the closure of defined benefits, particularly in the public sector in a whole range of countries. It is frankly, not that difficult. It is not that difficult. The earlier you do it, and if you preserve the future promise to the existing member, it is not that controversial or hard to do. If you believe, as I do, that they should be shut, that's a much more complex debate.

Important lessons? Well, start early. The longer reform is left, as we all know, the ongoing pressure of longevity, the fiscal issues, et cetera -- if you don't start early, the reform will happen, but it will be much, much more painful. And that's what Greece faces.

Secondly, keep it simple, simple, simple. I cannot emphasize this enough. When you have a system that's mandatory, you effectively bring in a group of people who are not well prepared to make lots of complex investment decisions or purchasing decisions. Keeping a system simple in Australia, I have to say, is far too complex. It's the most complex defined contribution system in the world. It's not a design operation that I would recommend, and there are far too many electable options, and I'm not including investment options. It is too complex. That leads to the need for intermediaries, additional complex administration and investment and distribution costs.

Phasing it in over time to minimize economic disruption -- obviously, if say tomorrow, a mandatory or soft mandatory DC system, 5 or 9 percent, you'd fall the economy. You'd shift consumption so quickly to saving, you'd floor the economy. So phasing in over time is important. I'm a great advocate of independent arm's length diversified investment, independent from government, particularly, and I think that's a particularly great strength of the Australian system. Diversified, independent long-term investment based on independent decisions of trustees on behalf of members.

Compulsion I've touched on -- I'm a compulsion man. The use of default solutions is very important in a DC system. Effectively having auto pilot solutions for members on fund, on investment, on aggregation of multiple accounts is very, very important. You can argue all you like and offer all the options and choices, but at the end of the day, having effective default solutions and choice options, but effective default solutions for individuals is very important.

Flow in prudential oversight. When you're dealing with large growing funds, as we are in Australia which will be global entities, investment entities of massive size in the next 10 to 20 years, you need firm prudential oversight and full transparency on operation.

The other two lessons -- scale is very important. The more a system is fragmented, the more individuals purchase, it lacks scale. There's a clear relationship between lower investment fees, lower admin fees and having scale economy in the features of a system. Australia has a large part of its system as individual selection trustee management. It's a very expensive road to go down.

And the last point I'd make is -- and again, didn't do this well in Australia, don't over promise. The reality in a DC system is it doesn't solve the problem of a, however you define adequate retirement income, for participants in the next 10 or even 20 years, because the importance of outcome in a defined contribution system, whilst fees are important, investment is important, the critical determinant is time in the system. So, someone retiring in Australia today has a very modest average of about 90 or $100,000. That's not a lot of money.

But that same person working another 20 years, once the system becomes fully mature, will have an average account balance four times what that same person has today. Time in the system. And not over promising and just pointing out the DC -- there are lots of advantages and disadvantages, but DC is an overtime solution. And in the Australian case for the considerable majority of people, a supplement -- a useful supplement growing over time to the basic state pension which is means tested. I'll finish there. Thank you. (Applause)

MR. JOHN: And Nick will be around for questions in the second part of the program. Our second speaker is Josef Pilger, who is the Asia-Pacific pensions practice leader for Ernst & Young. He has worked with governments and providers and both policy and practical solutions. He has 20 years of experience in wealth management, life insurance, et cetera in the U.S., Europe and Asia.

He advises both the Malaysian and Hong Kong governments and was a member of the Australian government's Stronger Super working group. And prior to come to Australia, Josef led a business performance improvement program for 7 of the 10 largest German public pension -- public sector pension policies. Josef? (Applause)

MR. PILGER: Thank you, David, ladies and gentlemen, for these kind words. It's quite internationally -- if I can say what David didn't say -- I was born in Germany. Kind of have been living in Australia for many, many years now, working in Asia, and now, talking about Asian pensions here in Washington. I think that very clearly underpins our introduction speech around international and international experience. And hopefully, we'll be able to learn something from it.

I think, as you can see from Nick's -- and let me start to keep the time -- from Nick's presentation, I tried to differentiate a little bit between policy and policy debate and policy discussion and implementation. And having led as (inaudible) our pension fund myself in Europe for a few years, I spent quite a bit of time on good implementation. Because the best policy is not necessarily very useful if you don't have good implementation. And hopefully, I will share with you some expertise and some experiences on those fronts.

One of the key things that I've seen -- I gave a speech about two weeks ago in Singapore, and I think one of the key messages for me is, I think we need to industrialize pensions. And however you want to call it, whether it's pension or retirement, I think in the past, it has been a system that has been exceptionally complicated and difficult to understand outside of these four walls.

I think those of you who are slightly familiar with the AIDA sales and marketing concept probably will appreciate that, and I always start to bring the experience up from my wife, who wanted to buy a new car about three months ago. And she had the very clear desire -- it was very, very simple to walk into a shop and buy a car, but the car salesman didn't talk about the performance of the front light bulb or the thickness of the glass. It was all about experience,

and she basically translated that desire into action reasonably quickly.

The key difference in pensions is for most people outside of these four walls, they start with the A in AIDA, attention. And I'll show you later on a very, very good experience from Malaysia why that is important for pensions. But I think, just starting off with a little bit of a game, and I promise you, it won't take more than 30 seconds. The key message and the key experience for me in pensions is, particularly when you look around the world and try to compare, it never is what it's supposed to be or what it looks like.

As I said, you've probably seen some of these wonderful pictures yourself. All of those lines are actually pretty much the same, and I think that applies in pensions, as well. In principle, pensions are a very, very simple business. We just make it awfully complicated, and for sometimes very good political reasons and taxation reasons, and so on. But hopefully, I can share with you some of the expertise.

And what I'd like to talk about today is a very, very short overview on mainland China, Hong Kong and Malaysia, and hopefully, that gives you a bit of sense, what is it that we can learn. All these three countries start from different angles -- China. One of the key things that I tell my staff around the world is, if you want to learn anything about pension theory and policy debate, go and study what the Chinese have written, because they have written about everything.

Now, the problem with China over the past decade is, they have been paralyzed by trying to define and develop and implement the ideal system. And I think that the key point here is, China hasn't really, for a decade, been able to move from discussion into implementation, with the consequence that a large

chunk of the population had nothing. And I think the important part of China is, we talk about China as one country. Now, for the United States, that is correct, because it's a sort of reasonably homogenous kind of country.

If you visit Beijing or Shanghai, as I do very regularly, that is like New York or Washington, very, very developed. If you go to the western part of China, it's a third world country. So, really trying to implement a pension system that suits everybody is exceptionally difficult. But what has China achieved? And I think initially, it's more the fairness argument that Nick was talking about earlier on.

China wanted to give and share the wealth of the country that it has established over the last few years more with the broader side of society. And what they have achieved in a very, very short period of time -- and we're talking about the last three, four years, essentially, 500 million people are now enrolled in their rural pension system.

Now, why is that percent? That is about 90 odd percent. If I look at 401K -- 401K had 30 years to just achieve 50. So I think there is probably a lesson learned in what Nick was talking about, some side of mandation. Two hundred million in the urban space.

I think the element of this statement is probably still true, that China will get old before it gets rich. But at least China is trying to do something about it, and one of the things that I've been told by some insiders, now that the government has changed, the government hopefully will be able to take control over the military, pensions will be on the top agenda in the next year. So there is quite a bit of emphasis on implementing pension reforms next year.

One thing I'm particularly fond of is just a mathematical game. I've

taken the Australian size of the pension assets per capita and just applied that to China, and did heavy discounting of the number that comes out, because otherwise, the number is just enormously massive. But still, with that heavy discounting, you get to 50 trillion U.S. dollars in assets. And that's still not enough for China. But what it shows very, very clearly is that there is an enormous amount of demand, but it's no good in trying to find the best policy if you don't implement it.

And I think there is another element which you don't see here in the public sector space. China has about 3,000 pension funds on province level, on city level, on local level trying to implement. Going back to Nick's point, there are no economies of scale. There is no sharing of expertise. So on the policy side, the policy that they come up with is actually not too bad. But now, they're struggling substantially with the implementation. And I think that is something we need to consider quite carefully.

If you look at Hong Kong, completely different part of China sort of technically. Very mature market. Went through the GFC. The system was set up 12 years ago and started off to address longevity. So, no particular secrets behind it. They have five percent employer contribution, five percent employee contribution, mandatory system. Unfortunately, reasonably low cap.

But what has happened throughout the GFC, a very, very strong emphasis on low returns. And with that focus on low returns, people ask the question of what do I get for my money. And therefore, extreme focus on fees. Now, why is that important? That is important, because what you had -- the industry has been debating and the government has been debating, and it hasn't done anything for a long time, for about three years. That's a long time in that

space for Hong Kong.

But long story short, you have every day of the week -- in the Washington Post equivalent, a headline article -- whole pages of how bad the system is. And I'm not going to repeat some of the words, because some of them I couldn't read, because they're in Chinese. But to me, what has happened is, it's a fantastic negative example of what we can learn from not doing anything in pensions. Because what it has achieved is, it has actually really unified the entire population and forced the government to do something about pensions.

Now, what you can see quite quickly, exactly those points that Nick made earlier. Economies of scale in delivery. Very, very simple thing that is very often forgotten. Now, when you have 15 percent return in 401K plans, whether you pay 1 or 1.2 percent in administration fees doesn't really matter. But if you have zero percent return, it matters. And even if you have 10 percent return plus, having the difference between 1.5 percent or 0.5 percent still matters a lot, because over the long run, it still can consume up to 25 percent or 30 percent of your capital that you get later on. So, there's a substantial focus on fees.

I think the other element is, as an evolution -- and I think I would probably not necessarily what you have ahead of you as tinkering -- I currently would call it -- it's evolution. What I mean by evolution, what we're seeing in Hong Kong, it's a little bit like your children. They grow up. Hong Kong established a system 12 years ago. It was a baby, and now it's time to focus on other things. And we see, if you compare countries like Singapore, they're already on level five of a level five study, and it's about adjusting, rather than tinkering with it.

If you go to Malaysia, and I think Malaysia is an interesting candidate, as well. Malaysia, very similar to the U.S., introduced many, many years ago a mandatory government run system, 16 percent contribution. Substantial. Unfortunately, the returns are not necessarily as great as people thought.

But long story short, the government realized as part of the economic growth plans that the pension system is insufficient, so they topped it up with a voluntary system. That voluntary system basically was introduced late last year, and a small number of providers saw that the smart idea of economies of scale was already very, very clearly introduce to try and maximize efficiency. But what you can very, very clearly see, the take-up on the employer’s site, the take-up on the member’s site, even though there were very substantial tax advantages, wasn’t enough.

And remember my AIDA concept? Attention, interest, desire, action? We had to get to A first. And that A takes time. So, what Malaysia, I think to me has very, very clearly demonstrated is the power of mandation or nudging. If you don't do it, don't expect people to change behavior, because it’s much, much more fun to spend more money now, as I’ve done in New York, shopping, than to put it aside. And I think that is probably very, very human.

So I think to me, a very, very good lesson -- I think also a very good lesson in behavioral finance behind it. As I said, one of the things I find is, we as an industry are far too complicated for the ordinary person. So, I think simplicity to me, is a very, very important part, and I think behavioral finance to me teaches us a lesson. But I think we talk about it a lot but don't do much about it in real terms.

And I think to me, ask yourself -- if you walk out of this room, go and talk to a friend tonight or your partner. What do they want to do in retirement? Now, that question in itself already has so many different variances, because what is retirement? I never want to retire. I want to work until I'm dropping, because otherwise, my wife will kill me (Laughter).

But other people see it as entitlement. When I'm 60, I want to retire. So I think understanding what my behavioral purpose of that question is, is enormously difficult. And I think to address it -- and I think Nick made that point about mandation. The mandation with defaults (inaudible) makes it much, much, much easier.

What is it that we can learn from Asia? I think number one, the fee side of things is enormously important. And I had the pleasure to do a study last year in Hong Kong, and I included 401K plans into this. I think there is room for improvement in that space, because given the scale of the market, 401K plans are more expensive here than their equivalents in Hong Kong, which are about 2 percent of the size. Question why?

I think the other point is competition. Is there really true competition in the market? Can I get into these, or are we having restrictions in shape or format. And I think in voluntary systems, 401K, distribution is king. So if I don't have distribution, then really, being a competitor in the 401K space is difficult.

I think what I see, as well, and I'm not sure to what degree that comes to the U.S. that much, but the cooperation of regulators. I can only warmly invite you to go on the IOPS, the International Organization of Pension Regulators. They have published a document late last year or the year before,

18 months ago, on what their expectations are on pension regulation moving forward. And it's probably fair to say there is an industrialization happening in this space, so we will be forced to drive that industrialization if we don't do it in advance.

And I think with my commercial head on, I would say, I'd rather give away 10 percent of my freedom today and keep the other 90 percent much, much longer than being forced in two or three years to give up 50 percent of my commercial freedom. And I think that is usually pretty hard. But there is a very good case study. Now, the darling of the OECD is Mexico. Now, I personally must say, I didn't necessarily pick Mexico as the preferred place for pensions, but there are some very, very good structural things that Mexico is doing on the pension regulatory space.

Just conscious of time, I think the key other point in learning is around government action. I think what I personally can see, what you can learn from Hong Kong is, if you don't do it, then government will be put under enormous pressure. And the good or bad side of pensions is, it usually concerns everybody. And that means if you upset everybody, they are all against you. And I think the pressure in Hong Kong was enormous, so I'm not doing anything on that front. It's very dangerous.

On the China side, also to me, a very good learning point, and I'm not sure whether that is applicable here, or too much to be learned from here in the States, but a decisive action -- very, very quickly can cut through the debate, what is the best system? And my learning from China is we will never get the best system in place, because it will be far too complicated. So you might as well be pragmatic and say, we have a road map of the next ten years in which we will

develop the best system, but let's start somewhere. And that somewhere is a compromise.

What I'd like to leave you with is maybe three general questions to consider. I think one is the size of China. And I always use that example when I talk to private sector providers, asset managers and insurance organizations. I say, we had the era of American companies coming to China. Now, that will be reversed. The number of Chinese organizations that are looking at setting up shop outside of China is enormous, and they have deep pocket. It's unbelievable. And they now do have the will and the capabilities to do it.

So, really thinking about what does that mean for us, particularly from a private sector provider, but also, is there anything to learn? I think knowing that the word "mandation" may not necessarily be very palatable, I still follow Nick's view in terms of mandation. Whether that is an opting out or a hard mandation I think is a different story, but my key learning from 401Ks, it has taken 30 years to get to 50 percent penetration.

If somebody would have taken the hard-nosed approach, let's say 20 years ago to say we talk about mandation, I think the U.S. -- we wouldn't be sitting here today. We probably would be talking about the U.S. having 20 trillion assets under management. We probably would be talking about other things in terms of how we can refine it and maybe talk about particular tiny little groups, rather than big groups of people.

And I think the other, final point I want to make is, (inaudible) my introduction, kind of having worked in different parts of the world, I have a very simple view. To me, the glass is half full. It's not half empty. Pensions, there is a lot we can learn. How we implement it locally is a totally different story. I

absolutely agree with you. In terms of how we implement it, there are restrictions -- political, economical, tax, you name it.

But in terms of lessons learned, I think there are a lot of lessons learned from overseas, and I would always like to invite you -- if you go home today, write down the three things that would help sorting out the U.S. pension system. And then, ask yourself -- give it to somebody else that should write down the answer, and you will find to a large degree, we are fighting against the vested interests of some particular group.

As I said, we're probably not naïve enough anymore to say we can fight this battle, but very often, what I'm trying to move and encourage you to do is to say, let's acknowledge it and let's see how we can find pragmatic steps, rather than trying to aim for the best solution in the world, but ultimately, not deliver and deliver one thing. I think all we are doing here, our role is to deliver retirement outcomes for Americans. So I think I'd better pause here. Thanks very much. (Applause)

MR. GALE: All right, well great. Thank you both for very informative and entertaining talks. And I'm sure that the people in the audience, if you're like me, you've already gotten some questions and you've already learned some lessons, one of which was just said was don't upset everybody. It turns out that's not a good idea. Choose who you upset.

Actually, before we bring the speakers up here for questions and discussion, we have three people who are providing comments on the presentations or comments on the issue more generally, and a very nice panel set up. So you'll hear from three speakers. I believe you have bios for them. I'll just introduce them briefly right now, and then they'll just come up in turn.

Steve Utkus is the director of the Vanguard Center for Retirement Research. He's done an enormous amount of work on retirement systems and policy, and his work is always marked by a combination of extremely clear thinking as well as access to superb data. So he'll be our first speaker.

Our second speaker is David Harris. David is the managing director of Tor Financial. He's had extensive experience in the financial services industry around the world. An underappreciated aspect of the forums we're talking about is the way they are mediate through the financial services sector, and David will be talking about that and other issues.

Our third speaker, just to make things interesting, is also a Harris, Ben Harris. Ben is a recovering former research assistant of mine. He is now a senior research associate at the Urban Institute and he recently served a stint as senior economist at the Council of Economic Advisors, and he'll be talking about some aspects of the U.S. experience. So, after each of them speak, then all five of them will come up and we'll have a panel discussion. Thanks. Steve?

MR. UTKUS: Thanks very much, Bill, for that introduction. I have a few brief comments on Australia. I've been traveling to Australia for a decade or more working with our colleagues down under at Vanguard Investments Australia and I'm delighted to provide you with just a few thoughts from what Americans could learn about the Australian system.

So, we'll start with a thought experiment. What if Congress in a very late session, maybe has a rider or two, an obscure transportation bill (Laughter). I guess no transportation bills are obscure anymore. But suppose there's this obscure rider, and Congress did the following: Repealed the Social Security system and replaced with a means tested flat dollar benefit paid out of

general tax revenue at the percentages that Nick just described; introduced a mandatory -- I'll make it 12 percent contribution to a private savings plan -- now this could be employer, employee or both; repealed ERISA and the employer centered retirement system?

Now, here I don't mean repealed any fiduciary standard, but really, repealed the law that made central to the retirement system decision making by the single employer as sort of the locus of fiduciary decision making. Now finally, if that wasn't enough for this rider, broaden the income tax base, raise the top rate to 45 percent, limited tax benefits and retirement savings for top earners, introduced a broad-based -- that tax, and then used all of that to pay for the old age pension as well as universal health insurance. Welcome to Australia (Laughter).

So the reason why I bring up this thought experiment, I call it, is -- the lesson I have for you as analysts is, if you approach the Australian system from the point of view of fiscal sustainability and entitlement reform, what you see is a mean state tested -- means tested state pension, and you see this robust private savings system. If you're concerned about issues of universality and equity, as Nick pointed out, you approach this as a compulsory employer funded pension system.

But I encourage everyone to say, when you think of Australia, think of both. It's not one or the other. It's the two, and really all of the components of both the pension system, the health system and the tax system in an integrated whole. And as I say here, it has both what I call market centric elements and it has these social Democratic elements that sort of merged and meshed together.

Now, I don't think any of us imagine that Congress would pass this rider I just described. So, you know, reform starts with the point that your anchored at. If we believe in behavioral economics, start with that anchoring perspective. And we're not going to move to the down under system, but what lessons might be learned? So I have three sort of lessons to learn and three lessons to avoid.

So the obvious one, and this is really what both speakers have said, the question of compulsory private savings is the first and most obvious lesson to think about. In the U.S., compulsion is very simply defined. There is compulsion in the state pension system, Social Security, and all retirement savings. Beyond it is voluntary. And that’s why in 30 years, only half the private sector workforce is covered by a private pension.

So, I think the fundamental question that Australia raises for U.S. analysts is to what extent should there be compulsion in the system, broadly speaking? And then, how do we partition between the state system and a private system? And note for those of you who survived the wars of Social Security private accounts, this is not about carve-outs and add-ons to the state system. I think Nick made this very clear. This is about sort of an independent decentralized privately managed pension system in parallel with a state pension system. The old age pension.

Now, following quickly on that, one of the most interesting things about the Australian system is that the locus of decision making is no longer the employer, but is what I call a new type of financial institution. I refer to them as the pension banks. That’s my fancy title for superannuation funds, basically, a new type of financial institution dedicated to managing sort of retirement savings

independent of the employer sector.

So, the obvious question it raises for the U.S., even if you don't believe in compulsion, has the U.S. system become too employer and particularly single employer centric? So concepts like multiple employer plans -- not multi employer but multiple employer plans and consolidated and economies of scale across employer is one of the lessons from Australia. And I do think this is an important, often neglected point. The superannuation funds are independent legal entities from employers and have their own CEOs and corporate structure, and as Nick mentioned, their own fiduciary conduct guidelines.

And then finally, of course, this is true of all mandatory system, but there's significantly less leakage. So, if you're not a believer in compulsion and you're not a believer in sort of superannuation pension banks and you still want to stay with the U.S. system, there is the fundamental question about whether the U.S. system remains too flexible and is just really too -- it's too liquid, in a sense when people change jobs.

In particular, you know, upon job change, a hundred percent of all assets are available for spending by households, and that's pretty substantially different from even the other systems that are voluntarily configured. So if those are the lessons to consider, what lessons might we avoid? Interestingly enough, you know, Australia has as its central point that most people are in defaults, and the U.S. is moving in that direction. We predict by 2017, over half of U.S. investors will be involved in -- will be invested in -- 401K investors will be invested in professionally managed allocations, not making decisions on their own.

But one thing about Australia is that the most common defaults are quite heavily oriented towards equity, with 70 percent or more in growth assets. And one of the lessons, of course, is whether that equity exposure should decline as people get older as in U.S. (inaudible) funds. Now, before you sort of get it on -- you know, have that sort of American hubris that we know better than Australia, realize I spent more than -- the better part of the early part of the decade defending the U.S. default policies, which were to invest people in cash investments for the longest term, before pension protection acts. So, I had to be embarrassed by that for many years. The Australians had a better system then, but maybe we have an idea or two to offer them about our defaults now.

Second idea. One of the interesting consequences, when I first went to Australia, only a quarter of the population was means tested partially or fully out of the state pension. Now, it's nearly half. And so there's rising longevity risk in the system. Now, the system counter balanced this. As Nick said, they've increased the relative generosity of the state pension over time. But one of the interesting questions is, can you imagine a world in which most of the benefits payable to at least half of the population have no annuity component and no necessary sort of hedge against longevity insurance? That's something to think about carefully.

And finally, I'll just close with a comment that I observed really in a lot of mandatory systems, which of course, is a focus on investment performance and net returns to the investor and an inattention to costs. Now, Australia has taken some important steps with disclosure, but I've always been struck by -- it's not true just of Australia, but other mandatory systems, that this sort of inattention of the sort of public scrutiny of costs has always been so low, particularly in

mandatory systems.

Now, I think that is changing, but certainly, one of the things we want to learn, particularly, is how to pressure planned fiduciaries to more attentive about cost and less attentive to net returns. Thank you. (Applause)

MR. D. HARRIS: Ladies and gentlemen, good afternoon, and thanks Bill and David for the invitation to come and address you today and also Brookings and AARP.

I have a social security number. It goes 212-51-33 and I still remember the other bits. I was here from 1997 to 2000. Fifteen years ago, Congress and Mike Oxley decided to have a hearing to look at Australia. His reaction was twofold. He thought that the Australian pension system would not work in the U.S. because of the nature of compulsion. “Americans just don’t do it this way, David.” The second question he posed to me was, “Have you ever played Royal Melbourne?” He was meaning the golf course, Royal Melbourne. I said, “No, Royal Canberra.”

The second congressman who made a vivid comment to me was Congressman Nick Smith from Michigan in 2000, where he said, “It is morally inappropriate, David, that you tax in Australia the contributions, you tax the income on the fund, and you tax the disbursement coming out.” And it was an interesting ration and the second comment we got into was dairy farming and having grown up on a dairy farm we shared many discussions on dairy farming.

But I think that summarizes really the interest politically then and now. Four congressional hearings over eight years I was involved in on Australia, and certainly, for congressmen and congresswomen, especially, they looked at Australia and said, “Interesting, but how does it apply to Australia?”

So what I'm going to do is look at Europe in about nine and a half minutes and look at six countries in particular and how they're approaching pension reform. If I can do that in now nine minutes and come back to you and look at how Australia is shaping their thinking. I'm going to talk about Germany and so (inaudible) should probably be here in this hot seat. But I've been looking at Germany now for 12 years, and I can't stress enough, Germany's population is rapidly aging, and rapidly aging especially in East Germany. You have fantastic infrastructure, fantastic roadways, fantastic roads to get to towns in East Germany, but the challenge you get to is when you get to the town there's not many people there. And the people who are there are quite elderly.

So what do you do? Well, you've got a generous pay as you go system and it's very generous. And, of course, for those people like myself in Generation X, Generation Y, the people come on behind, they're a little bit worried because that's quite a generous replacement rate -- 60, 65 percent. And quite a nice lifestyle.

Okay, there's review of occupational approaches, book reserves, unfunded liabilities. They're all a consideration but the big reform in 2001 which I admired was the Riester reforms. The Riester reforms came through after a series of commission inquires, but they're heavily tax geared and a lot of tax incentives. And what I would stress though about Germany is the charges associated with these products are incredibly high. So not only are you trying to give people tax incentives to lure them into this DC environment and to save and to ignore this generous first pillar, but the charges are quite high.

But in Germany, we have to remember that Germans have suffered hyperinflation and it's ingrained in their culture. Moms, dads,

grandparents, et cetera. They remember what it's like to lose savings and capital guaranteed investment solutions are very much part of the process in Germany.

Turning to Ireland, my dear friend Nick Sherry -- the Honorable Nick Sherry and I spent the first half or the first couple of months of this year in Ireland working on an OECD inquiry. And if I can leave two reports of books to look at, one is this Irish study by the OECD and the other one is *The Politics of Pension Reform* by a Swiss academic called Bonoli, which details and has a look at how pensions are reformed. But in Ireland what was interesting was the level of economic austerity. The Irish in America. Americans are fundamentally ingrained in the Irish culture but the sad reality is if I told you 32 billion Euros in one fell swoop left the National Pension Reserve Fund left it -- yes, left it. You have got this reserve. Ireland, you have -- the piggybank is broke. This is the EU. You have to spend this. The reaction in Ireland and for Irish people, do you trust your politicians? Do you trust your civil servants? A little bit of reluctance. This uneven coverage, this heavy contribution rates, and then Nick and I were looking at a case about the sharp decline in defined benefit. Sharp defined benefit is a lovely bit of crystal called Waterford crystal. If you got Irish roots your granny or your grandfather will tell you about the joys of Waterford crystal. Well, this business went bust but the unfunded liability of 300 million Euros was thought to be, well, you know, unfortunate members but that's how life is, but when you take it to the Court of Human Rights or the Court of Justice in Strasbourg and they say, "Actually, Irish government, that's your responsibility. You've got a bill of 300 million Euros." What does the Irish government do?

Well, the Irish government does get the OECD in January to do a pretty lengthy inquiry that had been running for six months, and you guessed that

the OECD inquiry recommends, and Nick and I were part of a review panel along with my colleague Sue Jones, looking at mandation versus automatic enrollment and the OECD punted for mandation. Mandation, compulsion. But a politician has to sell that. An Irish politician has to go and sell that to his populous. And they're still chewing that over at the moment. And the response, of course, is coming through. Chronic need for sustainable reforms. And I'd leave you with this sort, in Ireland, what drives their reforms is what's called social cohesion. How does unpaid workforce, how does unpaid mothers or fathers who are staying at home to look after the kids, how do they get part of the overall retirement framework? But Ireland is trying to address this issue but it is coming off a load base.

France. France. Ten years ago I stood in this fair country and said, "France would never encounter pension reform." I was one of the poor people last week that encountered pension reform firsthand when the air traffic controller said no to going to work that day, and of course, the air traffic controlled ground to a halt mostly in Europe because they were complaining about their pension contributions, yes, and their pension entitlements. They think it's outrageous that you can't draw your pension before 57. The train drivers there were muted to go on strike in two weeks' time and they want to get their 60 percent replacement rate when they're 54.

Hello, France. Come in, France. If there's any French people in the audience, I apologize, but the generous pay as you go, it's on borrowed time. It is, ladies and gentlemen, emotionally on the death row of social security reform. And what do we do? Well, the decline in DB is quite noticeable. Economic austerity is coming through. Buci is producing fantastic aircraft that I

fly all around the world and spend two and a half weeks of my life on mainly, on airbus product. But the challenge is those schemes to get the workers ingrained. And what they're trying with PERCO is their first tentative steps towards collective DC. And can I say all credit to the French government and Sarkozy's government beforehand who are trying definitely to move forward. The wider pension reforms -- aging, economic austerity, and industrial unrest, if you've got holidays booked in Paris next year, make sure that strikes are a consideration.

Okay. The United Kingdom. Bless. Look, it's the country of my residency now and I've done the citizenship exam so I'm soon to be a Brit, but nevertheless, a very modest pay as you go, first payola pension. You guessed it. Only 20 percent replacement rate declining over the next 10 years to around 15 percent. The United Kingdom has a special relationship with the United States. It has a special relationship, and I'm now going to say it extends, you guessed it, to pensions. Because one thing that introduced the British pension reforms was auto enrollment, behavioral finance, Sunstein, Baylor, Benatze. All got the British psyche and they went bananas with this pension reform. So imitation is the best form of flattery. They thought the 401k was the panacea. It works fantastically. Well, and let's go towards automatic enrollment.

It started last year, October. It's going well initially. Big large schemes. But they're moving towards target-dated funds but they are trying to do master trust. But the Brits have got one obsession, and the United Kingdom has an obsession. That obsession is price charges, fees charges, and capping fees and charges. And the economist in me will tell you that yes, you guessed it. If you cap it 1 percent, what is the market going to charge? 0.95 percent. Yeah, it's a challenge.

So sharp growth and defined contributions, underlying investments, collective D.C. is being muted, but what's important here is that the auto enroll model is allowing 4 percent eventually for employees, 3 percent by the employer, and one percent by the government by 2017. The inquiry of the Turner Commission, Nick and I worked on was in 2002. It's taking a long time.

So, but what's interesting about the Brits? The Brits are canny. If you opt out of their system -- if you say no, I don't want to be part of this, they'll reenroll you back in after three years. Not good enough. You made the wrong decision. You're back.

Okay. Let's jump across to the Netherlands. We're flying through Europe now. The Netherlands' generous pay as you go scheme, decline and define benefit, very much a trading nation, very open economy, and they have embraced two things -- collective DC and what's called defined ambition. For the actuaries out there in the audience, the old career average DC approach. They haven't worked too well. So what's next?

Well, what's next here after collective DC is this thing called pension premium institutional (PPI) bless. IOPS structures. What are you talking about? Dave, what is going on? This is an interesting pension structure where it goes cross-border. The ideal, one Europe, pensions going from France, Germany, you guessed it, into Spain. Will it work? Hey, early days. But there are 23 providers who are offering it in the Netherlands. So for multinationals it could be a solution.

But let's just rush up into the high fields and the ski fields into Switzerland. Finally mandation. We've gone through volunteerism. We've done some automatic enrollment. Now we're into mandation. I get it, mandation or

compulsions sounds a bit more palatable. Switzerland -- Switzerland is only one of two countries that decided to have a referendum on pension reform. That's great. A referendum. Go out one Saturday, what are you going to vote on? Do you want compulsion or do you want avulsion? And in 1983, they advocated compulsion. In New Zealand, the other country, in 1997, tax council compulsion and then they said -- 93 percent of New Zealand said we don't want compulsion; we want tax cuts. And then Chile on the side had decreed 3500 and 3501. But anyway, let's not digress.

But the critical thing about Switzerland, which is unusual, is 7 to 18 percent co-contributions varying on age. Younger workers start off small and the older workers have to -- their contributions increase over time shared by the employer. But what they do is provide underlying rates of return which are guaranteed. Love it. Don't democratize risk. Provide sort of an element of guarantee which inherently favors domestic investments. You guessed it. So the investment approaches in Switzerland are quite prescribed, and you guessed it, bonds, cash, and real estate in Switzerland have dramatically benefitted. And there was a national consensus, and Switzerland, you guessed it, gets the Guernsey number 1 as a percentage of GDP and pension assets. They are numero uno.

Okay. So I'm going to show you some pension asset projections that we've been working on in the last six months. These are assets for UK, Switzerland, Ireland no surprise, the UK with its, you guessed it, auto enrollment approach, and Switzerland going along ever so gently. And you guessed it, what you're seeing here is another -- sorry, I'm just going back a step -- is the Netherlands, Germany, and France. Again, I give France praise. I give them

marks for trying and to (inaudible) state. If you like, the train is moving out in pension reform gathering pace, and I think France is finally leaving the railway station all deciding.

I think the critical forecast on DC pension assets are interesting, no surprise. UK with the effective auto enrollment really screwing me up dramatically. This is use of cash equities and bonds and projecting forward with the account regulatory approaches. No surprise, Switzerland pretty static, and Ireland -- well, Ireland is Ireland. And what do they do? Okay, no surprise here. Okay, we're looking at Germany. We're looking at the Netherlands. But France flat-lining at this stage.

So what are the lessons for Europe from Australia? And this is what the Europeans look at Australia for. The political agenda, how it was developed, sharp DB decline, regulatory approaches that have been consistent. Two elements for the Europeans they consider about Australia. One is the coverage level, 91 percent, and secretary contribution considerations. Finally, administration and a plethora of accounts. How many accounts should Australians have? Thirty-two million for a population of 23 million? Who knows, but the Europeans are worried about the default solutions. And finally, the need for tax incentives versus, you guessed, no tax incentives.

With that in mind I now conclude. Thank you.

(Applause)

MR. B. HARRIS: Okay, good afternoon, everyone. Thank you for having me here.

I'm going to conclude with a bit of note of optimism when it comes to the U.S. I'm very optimistic about reform of retirement saving incentives in the

U.S. for a few reasons. One, as Gary noted, I look at this as a system that just needs tinkering. We can call it adjustment or tinkering, but the point is we don't need to take a bulldozer to our current system. It works pretty well. The second reason for optimism is that a lot of the reforms that we can enact are regulatory reforms or small reforms that don't require a lot of extra money. The United States, we're kind of in a revenue neutral environment at best, so coming in and looking at a problem and trying to throw money at it is just not a plausible solution. Fortunately for the U.S., I think we can get to where we need to be without spending a ton of extra money.

So just some quick reflects on the U.S. retirement system. U.S. retirement saving incentives outside of social security have a few characteristics. One, they're typically employment-based. They're done through the employer with payroll deduction. Two, they're basically regressive. For example, about 70 percent of the benefits go to the top quintile, they go to the top 20 percent of the income distribution. Another way to look at this is to say that all of these various incentives, tax incentives for retirement saving raise after-tax income by about 1.4 percent for the top quintile, by about 0.7 percent for the middle quintile, and not at all for the bottom quintile. So the incentives just aren't working for people at the bottom, but they work pretty well for many of the others.

And the incentives are primarily based on deferral, which makes it complicated. If we're talking about housing or other things, we try to incent through the tax code, it's not so complicated. You get the benefit in each year. The benefits for retirement saving incentives are quite complex and that makes reforming them slightly more difficult. We give exemptions for contributions, nontaxation of inside buildup, and taxation withdrawals. And as I noted, these

retirement saving incentives are not especially effective for low and middle income workers.

But despite all those drawbacks, many Americans manage anyway. My reading of the economics literature shows that most Americans are pretty decent retirement savers. And for those that aren't, the deficit on average is not particularly overwhelming. Here's an example from a study done in 2006 by Carl Schultze and others, who found that in the first decile, about 30 percent of savers were below their optimal target which means that 70 percent were adequate savers or better. Of those that weren't adequate savers, the mean conditional deficit, so the shortfall in their adequate saving, was only about $4,000. And going down the income decile, these researchers found that for the middle decile, for the fifth decile, only 17 percent were not meeting their optimal saving targets. And again, the conditional deficit -- this is in 2012 dollars -- was small. For people at the top, they're pretty much good savers. We don't need to worry about them so much.

Before I give these talks I sort of do this in front of my wife -- it's her punishment for being married to me -- and I showed her this table and she said she just didn't believe it. And that makes sense because this evidence is so contrary to everything we're hearing in the popular press. So if you read the Wall Street Journal, if you read CNN.com, the story that's being told is that Americans are terrible savers -- we spend way too much, we're not forward-looking for retirement saving -- but the academic literature I think suggests otherwise.

So that being said -- and I mentioned my optimism -- one reason why I'm optimistic is because automatic enrollment shows so much promise.

And it shows a lot of promise in fixing the shortcomings by those savers you saw in the previous slide.

Automatic enrollment, just a really quick overview. All it does is it keeps the incentives the same but it overcomes these administrative hurdles that people find themselves in and when it comes to signing up for these various plans, it's designed to increase participation and it recognizes the need to go beyond incentives.

So several of the prior speakers got up here and said, look, incentives just don't work. We need to think beyond those. And I agree 100 percent. And we're seeing that out of almost every single academic study comes out and says, look, automatic enrollment works; incentives don't. There was one study done recently, a very important study done by a study of savers in Denmark by Raj Chetty, who is this brilliant young economist. And what they found was that savers basically fit one of two classes. You could either be an active saver and a passive saver. And in Denmark, about 85 percent of the population were passive savers. For these people, incentives just don't work. But for these people, automatic enrollment does because they're basically just going along with inertia. And when we look at studies in the United States, you see the same thing. You see that we get to around 85-90 percent participation just by instituting automatic enrollment.

One question was brought up with the prior speakers is the question of mandation or compulsion. Well, that's a good question but automatic enrollment gets you pretty close to mandation. It gets you 90 percent participation. It's not that different. If we look at people's behaviors, it's not that different from a mandatory system because everyone still participates.

Automatic enrollment also has benefits that are spread across income groups. You tend to see the most benefits in the middle quintiles, in the second, third, and fourth quintiles. They're not concentrated in the top. That's because the people who are getting brought into the system by automatic enrollment, the people who are now participating because of automatic enrollment, tend to be middle income savers.

Lastly, automatic enrollment uses the existing saving infrastructure. We don't need to take a bulldozer to the existing system to get to where we need to be. We can just sometimes tweak it by automatically enrolling people and all of a sudden things look much better.

Automatic enrollment is not without drawbacks, so one of the problems we see are these low balance accounts. What happens if someone earns $4,000 a year, we're taking 3 percent of $4,000. Financial servicers just don't want to have these low balance accounts. It doesn't make them money. It doesn't make sense for them.

Another problem is lower saving for some and researchers have noted that people do what you default them into, and that's a great income if they're not saving, but if they were high savers before and automatic enrollment drops their rate of saving, they could be worse off. And lastly, we still have a system of regressive saving incentives and automatic enrollment does not change that.

There are many active automatic enrollment proposals. We had the Pension Protection Act of 2006, which successfully expanded access to auto 401ks among employers that currently offer 401ks. The president proposed in his budget auto IRAs, which automatically enroll most workers who don't have

access to retirement plans in a plan. We've seen similar congressional proposals that in many ways look like the proposal in the president's budget. But increasingly, states are taking the lead on automatic enrollment and states are taking the lead on saving issues. The most notable is California, who legislated a framework for retirement saving reform that not only had automatic enrollment as a feature but also had pooled saving incentives and guaranteed returns. The pooled saving incentives I think try to get at the problems that were also mentioned earlier of high fees and the fact that as Nick Sherry said, this is just far too complex.

And so the idea is taking some of the burden off the individual worker. California needs a few more steps to become law, but this could be the test case for the United States. This could be sort of the bellwether for whether or not automatic enrollment works on a large scale. So for all of us in Washington, D.C., who are interested in these policies, I encourage you to look at California carefully. If you want automatic enrollment to speed forward, California has to work. We have to make sure that California gets it right because it will be the bell weather for future states. Illinois, also, they didn't legislate the framework. They considered legislation for a framework. You know, less progress than California, but that would look very much like the California plan but with different management of the accumulated savings. But the point is states are moving forward and I'm optimistic about it.

And lastly, my last point, I'll just conclude with talking about decumulation. I think in the United States we have less of a saving problem and more of a spending problem. And by that I mean we're just not good at spending down our assets. We haven't put enough thought into it. Most of the thought on

the policy side has gone into how to get Americans to save better. The real question for me is addressing retirement risk by thinking about decumulation. You can have all the money in the world or you can have a fair amount of money at age 65. It doesn't mean that that money will protect you from retirement risk. In the United States, because of the way we treat healthcare and other issues, that risk can sometimes be higher.

So, for example, there's one study done at the Boston Center where they looked at shocks in retirement -- health shocks in retirement, and they found that the big wild care for people was long-term care spending. And we don't have a very good long-term care infrastructure in this country to deal with some of the risks faced by people. So it's not totally irrational for retirees to get to age 65 and hold onto their money as a strategy for dealing with these potential health shocks. Maybe they'll get sick and they'll have to spend a lot of money. Maybe they'll find themselves in a nursing home.

Decumulation is, in my perspective, the real problem. There are lots of opportunities for more robust insurance. One is long-term care. As a country we have to address this. We don't have a solution place. We have a very weak market that's very expensive relative to the benefits, and we need to look forward on long-term care. The reverse mortgage industry, theoretically, has a lot of promise, but in practice just hasn't reached that promise. And lastly, we need to continue to think about annuities. And not just immediately annuities that begin paying out at age 65, but deferred annuities. Deferred annuities can mean a lot of things in this country, but I'm extraordinarily optimistic about what we call longevity annuities. Longevity annuities are annuities that you might purchase at age 65 that don't begin paying out until age 85 or so. These

annuities have the benefit of being much, much cheaper for retirees.

So, for example, in the current U.S. market, if you want to ensure that you have $10,000 every year and you're age 65, it will cost you around 15 times that amount to guarantee that you get $10,000 for life. So it costs around $150,000 to buy $10,000 a year for the rest of your life. If you want to go ahead and buy a longevity annuity that kicks in at age 85, it only costs around $15,000.

Now, the benefits are different, obviously. There's a huge gap until you begin collecting benefits, but the point is it uniquely addresses longevity risk while allowing retirees to keep a fair amount of liquid assets to deal with these possible health costs to possibly pay for nursing home care. It makes a ton of sense to me and I think that needs to be part of the discussion going forward.

And lastly, as an economist, obviously I think there's a huge role for economists to help to inform the debate. But again, I think the focus should largely be on decumulation. Automatic enrollment to me seems like the obvious answer on the accumulation side.

Thank you.

(Applause)

MR. GALE: All right. Let's have all of our speakers come up. And while they're doing that let me thank Sarah Holmes for getting this whole thing organized. I'm not sure she's in here right now but she did a great job getting everything set up.

I was originally going to ask some questions of the panel and have the panel respond to each other, et cetera, but you've been a very patient audience, heard five speakers, so I think that what I'd like to do is just turn it

directly to questions from the audience with the proviso that the speakers will all have a chance to make final comments at the end.

So once again, thank you Sarah for all of your efforts organizing it, and there's a mic coming around, so Howard, first question.

SPEAKER: Could someone speak to how decumulation works in the Australian system of taking money out at retirement?

MR. SHERRY: Yeah, briefly, it's a lump sum siding system. So it's a draw down account. There is virtually -- well, there is no mandatory annuitization. And I'd have to accept that it's the last major policy challenge to consider in the Australian system. The current approach of a lump sum is unsustainable, particularly because we means-test the state benefit. For obvious reasons, if you means test a benefit and people can draw on the lump sum -- which by the way is tax free now -- you will draw on that lump sum at least in part to live on but also in part to maximize your state benefit because the means test. So it's a pretty critical policy set of issues that needs to be dealt with.

The only other observation I'd make is that Australia is not alone in that, of course. There are quite a number of countries that have either mandatory DC of soft compulsion DC where there is no mandatory annuitization. I'd make the observation mandatory annuitization is under huge pressure globally. Just look at annuity rates in the UK, where they have mandatory annuitization at a certain time and level.

And the other point I'd make about one of the downsides of DC is that when you have your own account, you see it as your money to spend as you want. And Australia has peculiar cultural traits around lump sum anyway, more broadly in society. I see it as a significant political challenge on top of practical

challenges to require any form of mandatory annuitization in Australia. So they're the sorts of challenges.

The only other point I'd make is we're fortunate we've avoided the early withdrawal debate. I mean, in Australia you can't withdraw the money early, unlike in the U.S. And many other countries for that matter. In New Zealand, you can draw it out for a housing deposit.

I'll conclude on this point. It just seems to me if you're all about tax incentives or mandation or semi-mandation for retirement incomes, why on earth do we allow lump sum and early withdrawals? I mean, is it the role of government in either quasi-mandatory or tax incentives to provide for all sorts of other uses for what's supposed to be a retirement income? I mean, there's an important set of issues around both fiscal pressure and I think philosophically the role of government given some of the practices we've ended up with.

MR. D. HARRIS: To add to Nick's comments, I think what we do have is a small annuity market, term certain annuities have developed. There is a fledging deepening of the market with providers like Challenga. Again, solvency, too, has an impact. The major consideration clearly is a product called allocated pensions or drawdown structures, and that invests the money in a pot and draws down, creates a pension, and then if you get to 85 the pot is exhausted and you go back to the state pension.

The critical thing though is what my dear mother Glory Harris encountered -- no offense obviously to all the other Harrises here today, but Glory was an interesting case in point. She'd saved for her retirement but happened in the mid-80s is the old-age pension changed. Where it changed for Glory was it became and income and assets test, and what was the residual of

her farming property became an assessable asset and her old age pension was dramatically cut. So your question is from that annuity basis was that intergenerational fairness or total unfairness.

MR. GALE: Gary.

MR. MITCHELL: I want to make a remark and ask a question.

The Lord Turner Commission may indeed come up with this 1 percent limit on costs, management fees. Actually, I'm shocked that it was that high. I thought he had learned more lessons from the past and my recollection was he had recommended a lower ceiling. But the reason for doing this actually is highlighted by the experience in Australia in my experience. When I was there about a decade ago, the costs -- fees management costs in Australia -- and this was insiders in the industry offered this estimate -- that they were 1-1/2 percent. I said how can that possibly be? You can voluntarily go buy a mutual fund in the United States for 10 basis points. Why in the world in a mandatory scheme where you're going to be managing trillions of Australian dollars should fees be this high? And they didn't have a good answer.

I would simply say transparency isn't enough. Transparency is not enough. I sit on the Brookings ERISA Committee and we are mandated by the Department of Labor to inform participants every year in a transparent way of the costs. And my suspicion is that less than one-tenth of 1 percent of Brookings employees read that statement of what the costs are. And I have never heard word one from a single Brookings contributor, any complaint about these fees. Although in my private view they're outrageous. The question is how --

MR. GALE: I just want to add that the -- I just want to add that the director of the retirement security project does not read the thing.

(Laughter)

SPEAKER: So has there been any evolution in Australia where there should be competition that drives down these costs toward actually reducing the cost. Or is it necessary to actually have mandatory ceilings, low ceilings on these fees, which seem unnecessarily high?

MR. SHERRY: Okay, Turn to recommended point three. The average fee in Australia -- I used to point this out both before I became a minister and after I became a minister, much to the concern of some people in the various sectors of the system in Australia. The average fee in Australia is 1.25 percent. Now, averages can be misleading but that's not a good fee level for an average. And it's been steady at 1.25 percent for 20 years. And I mean, in all economic theory, when the system was 150 billion 20 years ago and it's now 1.62 trillion, you'd think the fees would have come down; they haven't. And I think the -- I touched on it in my contribution. A far too complex system with very, very complex decision-making which leads to proliferation of accounts, complex admin, far too many investment choices, and a large part of the system driven by sales in the guise of advice.

There are some very, very major reforms which started on July 1 this year. I'd say modestly I initiated the inquiry that has led to those reforms for the reasons that I've touched on. But you're right. I mean, I used to get -- I still do get outraged when I see the fees. And 1.25 is an average. It's not unusual to get two. But I'll just make this point. I'm not a fee regulation man. Fees reflect costs. If you get the design features right -- in other words, you don't have too complex a system, you have auto solutions, you don't have intermediaries running around in the guise of advice selling you, effectively selling something --

why should you sell something in a mandatory system? You're in it anyway.

There are some pretty hard issues that sectors in Australia don't like a critique of. But anyway, there is significant reform around a whole set of these issues, and I'd be confident on everything that I know of it. We'll see fees drop on average well below one in the next five years as a consequence, but the bottom-line is keep it simple.

MR. PILGER: I think there is probably one additional element. I think we need to make sure that we compare apples and apples. And the reason why I say that, I had the pleasure about two years ago to do a study for the Hong Kong government and the Hong Kong regulator, and as part of that look around the world in trying to collect data to analyze the cost drivers and make recommendations for the system. And I think what we see very, very often, I learned a lot about cost and comparability during that study. I thought I knew it all but I knew now -- I know now that basically in many, many countries we have no standards in terms of comparing. And I think you're right; Australia looks comparatively expensive. If I take the similar kind of 401k statistics and so an apple for apple comparison, the U.S. looks exactly the same. And the fact that the U.S. is about, I think, four or five times larger in terms of assets, that is surprising. But I think you also need to look under the bonnet. And what I mean by that is what very many people often forget is there's a fundamental difference to the Mitchell Funds industry where basically I give you money, wherein the pension industry in Australia we spend about 50 percent of the money to get the money in the door and then the other 50 percent is investing the money. And I think that is quite surprising. I think on top of that it very much depends on is it a retail-style industry? And what I mean by that, a part of the Australian industry is

a retail-style industry where the employer has limited involvement. So all the economies of scale benefits that you have from joint administration, the employer pays to multiple numbers of employees disappears. What you have very quickly is it depends on the composition of the industry.

A big difference between Australia and Hong Kong, for instance, Australia has a substantial amount of larger employers -- employers with more than 500 people. And on that front you get some economies of scale and get technology solutions, straight-through processing and so on. Hong Kong, on the other hand, has a substantial amount of micro employers. I didn't know that that definition existed. Those are basically employers with one to three employees. And because of that fact, the administration costs are substantially higher because automation is much, much more difficult.

And I think my key point is I think we need to make sure that we compare apples and apples and that we actually include all the different features. And I think what I see (inaudible) agreement with the OECD, that I think they even admit that their comparison and their database is not necessarily an apple for apple comparison. And I think that to me is probably where we need to be very, very careful. And I can only encourage the economists amongst you. That is an area where I think the entire world has still substantial gaps in terms of research.

MR. GALE: All right, let me -- Steve, do you want to --

MR. UTKUS: No, that's cool. Go onto another question.

MR. GALE: Well, I was going to follow up to this question. So go ahead. On fees, yeah.

Let me ask my question first because I was going to ask -- I

thought you might be the right person to answer this. Let me define my apple here and we can make an apples-to-apples comparison.

Let's say you've got a system that's not employer-based. It's a centralized, mandated or automatic enrollment system. You've got mandated or automatically escalating contributions. You've got three broad-based diversified investment fund options. You've got no early withdrawals or lump sum distributions. How much can it possibly cost to administer a system like that? I mean, are we talking about 30 basis points, 50 basis points? Are we talking way down from 125?

MR. UTKUS: So in the U.S., and if you look at some of the large Canadian-defined contribution schemes, the large Australian schemes that have high rates of contribution like QSuper, if you sort of look at the benchmark from cost effectiveness management in Toronto, (inaudible) group, you can run those at 10 to 30 basis points; right? But those require affluent populations making high rates of contributions. And huge economies of scale at the firm level -- 50; 100,000; 200,000; right? So --

MR. GALE: The firm where the workers are working or the firm that's providing --

MR. UTKUS: That's sponsoring.

MR. GALE: -- their financial services?

MR. UTKUS: That's sponsoring them.

You know, the reason why Hong Kong has fees of 170,000-180,000 basis points is the typical employer in Hong Kong is a noodle shop or a garage with three to five employees.

MR. GALE: (Inaudible) next step.

MR. UTKUS: And this is what people say. So they're a typical employer. And so they have to build this huge infrastructure to interact with all the noodle shops in Hong Kong and all the garages and whatever, you know, small businesses. So I would come back, and when thinking about fees, the one thing -- obviously, economies of scale and market structure are critical. I would distinguish fee disclosure to close the loop with what Gary said, fee disclosure to participants versus fee disclosure to trustees and decision-makers. I find fee disclosure interesting to participants and a useful thing to do but I don't think people will react behaviorally. But if the U.S. fee disclosure under 408(b)(2), two sponsors is any indication, recordkeeping fees are now falling at a rate of 3 to 5 percent per year and there's heightened scrutiny on investment costs because of disclosure to decision-makers. And so in thinking about all these systems, you really have to decouple who's going to drive down fees. That's my lesson for Australia. It's really about changing the fiduciary standard for superannuation boards of trustees, not informing members.

MR. GALE: Great. Steve Goss.

MR. GOSS: Thanks, Bill. Great discussion.

Quick little point on the fees. The last I recall, I think Vanguard had, what, S&P 500 is about six basis points per year. It's maybe less than that now. I haven't looked lately.

One other little comment. Even the cumbersome U.S. social security system on the retirement side, the total cost relative to annual outlays or annual income, either way you look at it, it's about 60 basis points which on a 30-year holding period from the midpoint of your working career to the midpoint of your retirement career is about 2 basis points per year and that's an arguably,

old-fashioned, cumbersome DB plan.

But I guess my question really is to Ben. Ben, you hit on what I think is an amazing point. In the U.S., we have done a stupendous job, like many other countries, on encouraging people to save. Not only do half of the people have 401ks, we've done a great job and as Nick indicated in I think Australia, part of the reason for their great acceptance is because you give people statements about how much they've accumulated. People love to see the accumulation and people love to see the accumulation in their 401ks here. But that's part of the reason we've had such immense resistance towards buying annuities is because we have done such a good job of showing them these large balances. Why on earth would they ever want to give up a large balance to get this piddling little amount per month going on for the rest of their life which if they get run over by the truck the next day they lose all of it.

So my question I guess to you Nick really is with the wonderful thinking that went on in Australia to have the mandatory or compulsory -- however you want to call it -- plan for making people actually save up in the defined contribution plan, what happened that you didn't at the same time also get the compulsory annuitization?

MR. SHERRY: Because the existing DB system contained a 50 percent conversion to lump sum. That's one reason, lump sum. Australia is the land of the lump sum. It's the Irish convict in us. And it's true. It's a particularly cultural trait. Workers' compensation, compensation of death and disability, lump sum. Lawyers get into the system -- pardon me, I'm not a lawyer, and pardon my critique of lawyers but they love it. They go for it. They're the intermediaries in the case of workers' compensation. So it's a cultural issue. But it is also one of

the downsides of DC. It is a downside. I acknowledge that. And unless you deal with it early on, and we failed to do so in Australia, it's very hard to change it down the track. And I think ultimately the solution in Australia lies in not a mandatory annuitization but we have a minimum actuarial drawdown. You must draw a minimum and it increases each year. I suspect probably just adding a cap so you have a set of parameters on drawing down your lump sum over time so you can't overspend, nor can you underspend and it became an estate conversion which is not the purpose of a retirement income system. I suspect that's where we need to go.

But this is a big challenge in other countries as well. You've got to look at annuity rates. I doubt that mandatory annuitization in the UK is going to survive because the rate is so low.

MR. D. HARRIS: So just picking up on that, in the U.K. where I live, the Brits -- if you like, a country that's more ingrained with longevity risk. So in the culture of British people, longevity risk is considered and they are moving away from mandation. They're moving away from mandatory annuitization.

Now, but the critical thing is what they're trying to develop is flexible annuity products. A bit of fund management on the left-hand side, a bit of longevity risk on the right-hand side. They're trying. But the insistence also is that the British culture retiree is to simply stay with the life insurer and roll over. You've accumulated with this person. They can handle my disbursement. They've tried open market operations, shopping around, (inaudible) just roll over.

Quickly back to fees. Bill described really a model which (inaudible) recently in New Zealand, and the critical question you've got to ask in terms of administration and collection is does the government pay for that? The

Inland Revenue in New Zealand has got 320 staff that do and collections and do payments, and that's a big question you've got to make. And for the academics here as well, Union Super in Australia is only charging 48 basis points all up today. Administration holdup. Not a bad day for the thrifty academic.

MR. B. HARRIS: Let me just quickly jump on that. I think that Steve brought the point of framing. This is a big issue. At the beginning of my remarks I said that I was optimistic about reform because we could do reforms that don't cost money. This is one area that we can see reform that doesn't cost any money. Treasury is working on regulations to make it easier for firms to go ahead and present your benefits, not just as a lump sum but as also a lifetime income stream. This is really important.

More fundamentally, I think we need to change the national discussion from saying how much have you saved for retirement to how are you protecting yourself in retirement? How are you protecting yourself for longevity risk? How are you protecting yourself for long-term care risk or medical shocks or the death of a spouse? That's the real question. We should be talking about terms of protection rather than accumulation.

MR. GALE: Yes.

MR. FRANZEL: Josh Franzel with the Center for State and Local Government Excellence.

Sort of underpinning a lot of what we've talked about today is financial education; how do citizens wrap their heads around a lot of these concepts that they might not otherwise have had to deal with in their lives? With the countries we've talked about today, have there been a formal financial education component that's sort of been laid on top or laid alongside the reforms

that were put into place and the components that have stood up?

MR. D. HARRIS: As a regulator, we took Nick's lead as a politician as a regulator in Australia in the mid '90s and we had the Money for Trees campaign. The bigger question you have to ask is who is best at educating? Is it the government, is it industry, or is it an employer? The government at that stage between '94 to '96 pulled in 11 million Australian dollars in a very short period of time and we had to educate a population with an average reading age of 12 years old. It's probably the reason why we have beer that is XXX, 4X great beer in Queensland. But the reality is that we tried through the state to provide that education and then provide it by the employer through the traditional means you have here in terms of financial education. In the UK, you had sheepdogs running around in stakeholder pension products and that was put on by the Department of Work and Pensions. That had a successful NES campaign, and that's been successful. Again, is it the state, is it industry as collective, or is it the employer?

MR. PILGER: I think if you look at the Hong Kong side, Hong Kong, even though it's a mandatory system, the Hong Kong government spends north of $10-15 million per year on all sorts of education that you can imagine that basically starts from going to kindergartens and teaching children how to be more financial savvy in a very, very simple way, up to deep and very intense TV advertising. And Malaysia goes down a similar way. I think Malaysia has followed and realized with the very successful government system they basically have a substantial gap, not in terms of financial literacy but in terms of attention to long-term savings.

But I think the key question in both countries is always who pays.

Who pays and how much is enough? And I think if government pays, there's an easy solution. If a provider pays, the question is it becomes cost in some shape or form and it becomes fees in another form at some stage.

I think there's probably another two elements that I would like to raise. One is the expectation of financial education is I do it and it works. Yes, it works, but it's like watching a sand dune walk. It moves but very, very slowly. It is successful. It goes in the right direction. But don't except anything fast. I think that is the very, very clear experience from all the Asian countries that I've worked in.

I think the second point I wanted to make is I think we talk about financial education, which I think is very, very important, don't get me wrong, but my sense is we're still -- as my point during the presentation -- we are still as an industry far too complicated. And I think that is we might educate, but the question is -- and even if you listen to us here, I think the acronyms that we're using, if you ask anybody on the street what half of those acronyms are, they have no idea. And quite frankly, they don't care. And if you then translate that into a society of people that is not much, much more Internet savvy, we've got a study from Germany where basically they looked at how people gather information. And not surprisingly, 80 percent say via the Internet. Now, show me the pension fund that in normal human language actually explains retirement products and savings. I've yet to see that.

MR. GALE: Actually, let me just follow up on that. I think the New Zealand government has a very good financial literacy --

SPEAKER: Commission of Financial Literacy.

MR. GALE: One thing you said struck me. You said at the very

beginning, although saving in Hong Kong is mandatory, the government still spends a lot of money on it. There's another way to think about it which is because saving is mandatory, the government spends money educating people. The idea is that these things -- that mandatory and mandation in financial education are complements, not substitutes. So if the government is going to tell you you have to save, then there's some responsibility there to help you understand how to save and learn financial literacy. So I tend to think of these policies as complements, not substitutes.

MR. PILGER: I think there's one downside on the other end when we're successful with this, and we see this in the Hong Kong market as well. Some of the providers try to compete on service and you have online trading facilities as part of your pension accounts and people do day trading. They sit on the computer screen and do day trading with their pension money. So I think the question is is that part of what pension and retirement is about? Personally, I have a big question mark.

MR. GALE: Yeah, one of the good things about the financial crisis here is it wiped those people out.

David.

MR. JOHN: I'd like to look into the tax system in Australia for just a moment. Nick touched on that in his presentation.

Would you detail a little bit more about in particular the tax on contributions and whether the 9 percent figure given for mandatory is actually somewhat overstated?

MR. SHERRY: Booked in for dinner? It's a long story.

Tax I didn't even bother to go to because it's just yet another

complexity. Fifteen percent contributions, tax on all contributions, 15 percent of fund earnings tax, but it's effectively 7 to 8 percent because we have what's called divided imputation. It's 7 to 8 percent. I won't bore you with the complexity of that. And we also have zero tax in retirement at age 60, beyond age 60. That's a pretty good deal actually, and I accept your concern. Effectively, if you take 15 percent off 9 -- it's 9-1/4 now -- it's about, what, 7-3/4, whatever the figure is. And there's a cap on total contributions because obviously, to the extent that middle higher income earners can add voluntary contributions, and I mentioned that, they are the most significantly advantaged through that because the 15 percent contribution tax and the lower savings fund earning tax is of much greater worth relative to your marginal income tax rate.

It's a highly contentious issue in Australia. There was a very large debate about this earlier this year. The cost -- I mean, the R&E is the cost of tax concessions in a mandatory system actually go up significantly because you've compelled people into a tax advantaged form of saving. And it's a significant budget call and there's a significant debate around this and I don't think that debate is going to go away anytime soon.

MR. GALE: Yes.

SPEAKER: Hi. I'm Peggy from Bloomberg. I had two questions.

One is with the Australian system I think, and forgive me if I missed this, that you mentioned the average balance for people and it's only been in existence for a certain amount of years, so given that, do you have an average rate of return stripping out the effect that just the ongoing contributions would have? And I guess this may be maybe you, Steve, the second question I had was how realistic do you think it is in terms of the prospect for putting

through a mandatory system in the U.S. given the mistrust that people have of the financial services industry post-2008? Because there would have to be some sort of -- it seems to me there would have to be some sort of underlying trust factor for Americans to feel comfortable with then having this mandatory system going into a privately run system.

MR. SHERRY: That's a really good question. The average return will vary from fund to fund. There are different types of funds. I suppose the best way to do it is to illustrate my own fund. I set the fund up 25 years ago, but my fund, and I'm a strong believer in focusing on long-term returns in a DC system because of volatility. That is difficult from a human behavioral point of view, very difficult, because people from a human behavioral point of view focus on the six monthly or the yearly rate of return and forget the positive that went before it or hopefully the negative. But they tend not to forget that.

My fund returned me an average of +7.5 percent after all fees and charges; +7.5 per year, year on year, for the last 10 years. If I went back further I suspect it would be higher. That's a good return, and that would be in the top 20 quintile of -- the top quintile of funds in Australia.

I hesitate to give an average figure because I'm not -- I think on average 5, 5-1/2 percent would be around the figure year on year, 10 year return. And the figure I gave you for my fund, that included -22 percent in the year '08-'09. So that's why it's always important to look at long-term returns in a DC system. So even with a -22, I became minister in November 2007. And you know what happened in 2008. Not even we escaped it and certainly the impact on the markets. An average dropping in your DC account balance of 25 was relatively common. But that had a deep impact on individuals. There's no hiding

it. It did disillusion some people.

For 20 years we had positive returns and then all of a sudden -25 percent and people had come to the conclusion and the assumption that what they had could never go backwards and they'd forgotten about the +10s or the +5s or the +8s that preceded it. And it's a very, very particular human behavioral set of issues that do need to be thought about deeply in a DC system.

The other quick remark, and the point has been made, Australia is predominantly an equities-based investment on the default. This is my personal view -- I think that's a good thing because on all the data I've seen, equities, alternatives, and infrastructures on property long term, subject to fees -- and I deliberately emphasize subject to fees -- will outperform bonds and cash long-term in a DC system. So trustees in Australia have come I think to the reasonable conclusion that that is the best form of default, but it doesn't mean you don't have challenges around volatility, which some people consider risk; I don't. Diversification and an ongoing debate about trying to minimize volatility, i.e., lock it into bonds and cash. It's a fascinating debate in itself.

MR. UTKUS: That gave me enough time to think about a question, sort of combine trust and compulsion and the global financial crisis.

First of all, I raise the issue of compulsion because that's the obvious distinguishing feature of many systems around the world, including the Australian Compulsory Private Savings. And as I said, it's independent of sort of the government system. It's a distinct, decentralized privately-run system. And I think what you find generally, Americans, for example, trust financial services providers more than they trust in general their government but you can do the numbers. The financial markets I should say.

So I don't really raise compulsion in the sense that do I think Congress under any administration would compel Americans to save say 5 percent of their pay in a private savings account. I raise it because it's sort of the end of a potential set of solutions. Today we have automatic enrolment as a voluntary feature within tax-qualified plans. It seems to be capping out from my reading of the data that the employers who want to adopt it are sort of adopting it and sort of hitting at about 50 percent of large employers and less than a quarter of small employers, and it's reaching its sort of natural conclusion. So the next question facing Congress is a degree of compulsion, mild compulsion to say to employers in exchange for tax qualification of your plan should you have auto enrollment as a normal condition of operating the plan? And then there have been proposals about automatic enrollment in the IRA space for small employers. So on a realistic political basis do I think we'll be in a world in which there will be more compulsion? No. But it's sort of degrees of compulsion is the question to think about. And some of these softer compulsion methods I think would appeal across the ideological spectrum.

MR. B. HARRIS: Let me just say as someone who has both worked on the Hill and for the White House, and speaking for neither, compulsion is not going to happen. It just isn't. I mean, when we pitch auto IRAs to members of Congress, the first thing you have to say is this is totally voluntary and there's no cost to employers. And you have to say it 15 times. And they're still skeptical. So much so that some people are even worried about automatic enrollment being perceived as something that is taking money away from employees. That's the worry about the pitch. So compulsion is even more -- I think seen as being even more invasive than automatic enrollment. Unless the

political landscape in this country changes dramatically, it just is not going to happen.

MR. D. HARRIS: Just a quick comment about rates of return. Australia had the benefit of coming out of a recession in 1991 or 1992 and our economy taking off, and heavy weightings as Nick and Josef have alluded to, and to equities, especially mining equities saw people's rates of return soar. But if you compare that to Sweden, Sweden introduced its sort of auto enrolled sort of self-compulsory system in 2001. And people's take up, of course, was very active in investment options given for the first opportunity to get really active in investment selection, suffered a big hit, and of course, everybody raced to the default. I think the big question for the United States that Americans have to confront is will you allow leakage out of the system in the future on loans on 401ks? That is the big elephant in the room because a lot of other countries are saying no, it's only hardship to get the money back from your retirement savings.

MR. UTKUS: Actually, just to come back to you, my favorite research staring at me, it's not so much loans; it's in America your complete lump sum is accessible upon job change. Ninety percent of loans -- the defaults from loans are negligible. But just a subtle point for the tax people in the room.

MR. PILFER: I think from my just listening to the conversation, there's to me an elephant in the room and that is to me what do we define as success. It sounds slightly academic but I think we're talking on a number of different levels, and I think in a way the presentation earlier today on the 401k, I think to me what the U.S. has achieved is fantastic but if you look through the lens of the bottom quartile of people, they would say it's pathetic. Now the question is I can't answer either of them. I think it very much depends on what

do we want to achieve and what is success, and I think that debate has multiple facets and it's not just returns. It's not just having enough money in there. At some stage, and I think we had an interesting debate in Singapore a little while ago, it basically comes with what later on do we do once we have money? What do we do when we retire with our time? And I think my sense is -- what I personally hear is we need to first define what is success and then I think we can make judgments of whether we've achieved it and what needs to be done. And I think the Race for Performance is great but ultimately, over 20-30 years, very, very hard to guarantee unless we go back to the old defined benefits.

MR. GALE: Yes.

SPEAKER: I have two questions for Nick, and I would like others to comment on it.

My first question has to do with whether there was any pressure to allow for early withdrawals. It seems like in the U.S. pretty much the cat is out of the bag and I think it's very hard to roll that back. And my second question has to do with guarantees and whether there was any discussion about guarantees. I believe you said that -- forget which country, that there is a guarantee. If you could just talk about that a little bit.

MR. SHERRY: Okay, quickly. We have had the occasional outbreak of public debate about early withdrawal particularly around a housing deposit. Australia has a very, very high home ownership and strongly increasing property prices, et cetera. A lot of debate around that. For fortunately, I think, well, the industry for self-interest doesn't want early withdrawals because they want the money, but there's a very strong political will across the different political parties in Australia that this would be a bad thing. It's not the purpose of

a mandatory retirement tax-preferred income saving system to provide tax preferment for early withdrawals for any reason including housing. We've managed to hold that line pretty solidly to the credit of our political opponents, occasionally get the populist but you have to deal with those in all political systems. But the debate does come and go. But I'm confident we will not see early withdrawals of any -- we've got a very, very tightly defined hardship provision but the effect of withdrawal is miniscule to the system.

The second question went to -- oh, guarantees. A lot of debate around this when we debated within the government -- left of center government labor party around a policy on mandation and whether we should go down the government investment route. And to be perfectly frank, the internal debate in the labor party must have been unusual from a social democratic party was whilst we were strongly supportive of compulsion fairness to spread coverage that was seen as central to the new system, we didn't want to cop the blame if something went wrong on the investment side. So we didn't want a government vehicle for investment. We didn't want the government interfering -- you could call it interference. Some would argue it's not interference. We did not want the government prescribing any form of investment or participating in the investment side of the monies in any way, shape, or form. Now, as I've said, I think that's the great strength of Australia, so it is therefore the trustees' decision -- diversification, long-term decision-making, and there's no guarantee.

The downside, of course, as I've alluded to earlier, in a DC system, no matter how good the long-term return, no matter how good it is, even if it was a modest 4 percent, people lose focus on long-term returns and come back to the short-term. I'm not a guaranteed minimum return person.

Switzerland, which David has referred to, made some pretty fundamental mistakes in guaranteeing a minimum return and ultimately what do you do if you can't meet the return if it's set too high? Some other countries set returns as well but my colleagues might like to comment on that.

MR. D. HARRIS: Just a quick comment on guarantees. The United Kingdom is currently looking at this issue of defined ambition which was in a sense career averaging looking at the U.S. and also looking at the Netherlands' policy. It's an ambition looking for regulation at the moment in terms of policy hasn't come through. I'd stress that guarantees are expensive, and as a former competition regulator, the term guarantee is very emotive and gets the hairs on the necks of regulators quite concerned when the term "guarantee" is mentioned. So the Minister Webb in England believes that the employer should pay for the guarantee, but yet in the Netherlands people are walking away from those guarantees because it's difficult to see long term that an employer can commit to those guarantees. But fundamentally it comes down to this point -- are we seeing worldwide the democratization of risk? And I think that's what's happening is that people all over the world are confronting risk, and whether they're equipped to handle risk is the big question.

MR. B. HARRIS: With guarantees, in California, when California put together a framework for retirement saving reform, part of that framework was that there would be a guarantee. And the way this guarantee would be purchased is that all these workers were contributing 3 percent of their paycheck to a pooled investment saving would then see the managers of this pooled investment saving go to private companies -- MetLife, Prudential, other insurance companies -- and purchase a guarantee on behalf of the workers and the

guaranteed rate was assumed to be around 3 percent but it wasn't prescribed.

I think this is an awful idea for two reasons. One, as noted, it's incredibly expensive. I have no idea why MetLife or Prudential would ever want to get into this business but it would be really expensive to go ahead and guarantee a 3 percent return on assets. What this means is that you're essentially taking a large share of the contributions and using it to pay these insurance companies for the guarantee. The Boston Center for Retirement Saving has a paper on this where they look at what share of the contributions would be needed for various guarantees and they have things like a 2 percent real rate of return, 0 percent real rate of return, a collared rate of return. And you're looking at things in the order of 10 to 30 percent of contributions need to go to purchases and guarantees. They're incredibly expensive. And if the workers aren't paying for it, the government is paying for it. If the government is guaranteeing it, the cost is still born but it's being born by the government.

The second reason I don't like these guarantees is because we just had a financial crisis in the United States where asset prices plummeted and we didn't see it matter that much. I mean, this was a worst case scenario. Asset prices plummeted by like 50 percent in a very short period of time and people still managed. You know, it had a slight pain for people but in general things like declining housing prices, raising unemployment mattered a lot more for retirement security than did this plunge in asset prices. So I just don't think when you look at the benefits and the cost, the guarantees are worth it.

MR. GALE: All right, great. Let me ask if -- oh, sorry. Steve.

MR. UTKUS: I was just going to say on the issue of guarantees, that's accurately stated. I mean, the issue is who would be the natural bearers of

long-term capital market risk? Who will be your natural counterparty? So what insurers are doing in defense of my insurance colleagues is going out into the marketplace and buying long-dated puts against equity and bond markets from counterparties who are willing to provide that insurance. And you haven't really, of course, eliminated the insurance; you've just translated that insurance into counterparty risk and you've protected it with the capital reserves of the insurer. That's why it's expensive.

So I think the one benefit of -- I think the real danger with guarantees around the world is this belief that guarantees are free and not costly, and I think you underscored that that is, in fact, not the case.

MR. GALE: All right. Last question, Gary.

MR. MITCHELL: A simple observation about the guarantees. Remember, the United States' system has two other pillars besides this voluntary pillar. It's got social security and it's got means tested benefit for the low income population 65 and older. It doesn't seem as though guarantees are so necessary for the tier that as Ben mentioned is mostly going to the top one-half of the retired -- the old age income distribution. So we have a guarantee in the system. It is whatever guarantee the United States government can come up with to finance its means tested benefits and its social security. And most people feel relatively confident with that level of protection I think.

MR. GALE: That's a nice way to -- it wasn't a question but it was the last comment before the speakers sum up, but it highlights the interaction between the public system and the private system, which is a theme that is sort of bubbled around underneath the surface but is implicit in a lot of people's comments this afternoon.

So let's start with Steve and let me ask if anybody wants to make any summary final last word comments.

MR. UTKUS: The only thing I would observe is what you observed at lunch, so I'll let go what Bill said which is I think the point about these international -- studying these international developments, these non-U.S. developments, is not so much to suggest that they would be specifically applicable but they might reframe problems for us and allow us to have a broader sort of analytical or conceptual approach to problems than we otherwise might. So if, for example, in the case of retirement access to your funds, if all you do is think in the U.S. context, you think about how might we alter those rules. If you look internationally and see a wide range of choices, then you think about a set of policy prescriptions that might be quite broad. The same thing with whether it's compulsion or retirement income or fees or governance structures, I think we can all benefit from these sort of insights. And I still think Australia is a compelling example for us to consider even though many of its elements are -- well, it depends which element you pick -- are repugnant politically, but I still go on and talk about it because I admire the system a great deal.

MR. D. HARRIS: I think international perspectives are very useful as a sort of measure, a simulation for where the United States has to go look at the aspect of retirement reform. I think my experience of the subject in this country and having lived here for three years was that for congressmen and political policymakers, Australia is an exciting dynamic. Yes, it has embraced the thorny nettle of change or pension reform, but something more palatable may be in New Zealand and the UK, which I think has embraced automatic enrollment pretty heavily. I think the question is a more fundamental one, is what the OECD

are doing at the moment, is how do you measure pension reform success? And the two elements they're looking at heavily is contribution rates and coverage rates or access. And if you think the United States has succeeded in those two levels, fine, let's move on. If it hasn't, we've still got a lot of work to do.

MR. B. HARRIS: So on the question of accumulation, I think the answer is very simple. The answer is automatic enrollment. On the question of decumulation, I think we have a lot of work to do. Economists and policymakers have not decided how we would answer the question if a median worker came up to us with a median amount of assets and said what should I do at age 65, we have no idea what to tell him as a group. We haven't decided the best way to go ahead and protect against risks in retirement. There's no consensus answer. The way forward is first we need to decide on that answer and then we need to build incentives in a system that reinforces the best way forward for that worker.

MR. SHERRY: I think the point that's just been made is important, and I've acknowledge one of the weaknesses of Australia. In fact, the last major policy issue in my considered view is that post-retirement area. I've acknowledged and referred to some of the mistakes we've made on the way through, and I accept -- I'd be very surprised if the U.S. ever went down a mandatory or compulsory DC pillar 2. I'd be very surprised.

But I think if you look at Australia and you measure success by effective coverage, by a system that is sustainable, that delivers a safety net plus an increasing income-related benefit that is sustainable for the considerable majority of the workforce, it has significant economic side benefits around savings investment, which has helped grow the Australian economy. I think if you look at all those sorts of outcomes, Australia has done comparatively well.

But at the same time I would accept that you have to adjust your policy for your local political economic culture.

One final point though, and I do get impatient about this, is I do see defined benefits at pillar 2 is fundamentally unfair and unsustainable. I think it is appalling in a society when the broader society's effectively paying the retirement benefits of public servants to the cost of service provision given the cost is so great. And that's a very controversial view here and I'm sure as a former left of center politician my left of center colleagues wouldn't share those sentiments, but I am truly appalled by the continuation of open defined benefits in the public sector in both Australia and the -- sorry, in the UK and the U.S. because everyone else in society is paying for it and it's a very, very generous benefit that is utterly unsustainable.

MR. PILGER: I think from my end two points. I think, number one, the differentiation between policy and implementation. And I think that is my key lesson from China as I've tried to point out, the ideal system is fantastic but in the meantime the ordinary Americans lose out. So I think trying to apply some pragmatism.

But I think also going hand-in-glove with that, my second point is trying to define what is it that you want the system to do and be transparent about it and then measure against it. And my comment early on about 401k, what has it achieved? I think if you look at it from a holistic perspective, a lot. If you look at the bottom quintile, probably not much, but the question is whether it's supposed to achieve it. And I think if we're clear on what we want to achieve, then we can influence politicians much, much stronger, rather than pulling people in all different directions. And I think that's probably my point I'd like to leave you

with is pragmatism probably makes sense. You can always evolve systems. I wouldn't necessarily call it tinkering because tinkering to me has a negative connotation, but evolving. And if you think about your children, they haven't gone to university when they're seven years old other than a very few exceptions, so let's be generous and let's evolve the systems as well.

MR. GALE: All right. Thank you.

As you mentioned, you can always evolve the system. The thought that popped in my head was that I think all the countries we talked about who have done these great reforms to their system, their retirement system, have parliamentary systems of government and in the United States you can't always evolve things very far. So that's a topic for another day but it's an interesting thing to think about how the former government affects the ability to make changes.

So thank all of you for excellent questions. Thanks to Sarah again for the administrative work and I hope you'll join me in thanking our speakers for an excellent presentation.

(Applause)

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