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CHALLENGES FACED BY MEMBERS OF DEFINED CONTRIBUTION PLANS

On average, we are now expected to live longer, healthier lives and this might seem to be good news. The proportion of the Mauritian population aged 60 and above is expected to be 30.2% in 2052 compared to 12.3% in 2012. Given higher life expectancy, we should seek to be better financially prepared as individuals, as families, and as a nation. This could happen by obtaining a decent retirement income.

One way to receive retirement income is by making contributions into a pension fund. With an ever growing ageing population, it is likely that more and more retirees will depend on pension income as a source of wealth accumulation. The big question is however whether the pension funds will be able to pay them an attractive income upon retirement. In an Allianz Reclaiming the Future study (2010), 61% of Americans surveyed highlighted that they were more afraid of outliving their assets than they were of death.

Mauritius has a long tradition of voluntary private pension provision. Most are catered through defined benefit (DB) and defined contribution (DC) schemes established by private companies to provide pensions for their employees. At end-December 2012, the number of insured and superannuation funds amounted to 1,005 with total funds under management of Rs 35.5 billion. Traditional DB pension funds have been on the decline and are being gradually replaced by DC schemes. For instance, the Finance Act of 2012 made provision for the launching of a Public Pensions Defined Contribution Pension Scheme, for government officers appointed on or after 1 January 2013.

There are certain measures which could potentially help to generate a better or more stable pension income over time:

- **Educating and Encouraging DC participants to save more for retirement**

Unfortunately, not all people consider saving for retirement as a priority. Some may not be contributing to a plan while others might be relying on their employers to contribute. With people now living longer, there is no guarantee that such contributions will suffice later at retirement. It is important that members of pension funds, especially DC ones, make sacrifices, save more and contribute greater amounts to the pension plan. Education of members will be important in this respect. It is pleasing to note that the Private Pension Schemes (Investment) Rules 2013 recently published by the FSC treats beneficiary education as an important section of the investment policy statement of a pension plan.

- **Better asset allocation**

In the case of DC pension funds offering investment choice, members are asked to select their investments. Unfortunately, due to lack of financial knowledge, many choose in a haphazard way, either going for very low risk or else high risk investments. Short term factors also influence the choice. This may not be the best strategy and could potentially generate suboptimal returns in the long run. The closer one is to retirement, the more important it is to avoid mistakes. Members who are hesitating to choose may be encouraged to opt for the default portfolio, which is more balanced and is usually recommended by a specialist such as an actuary or investment consultant.

- **Lifestyling concept**

Lifestyling is a feature which can be offered by DC pension funds. When the fund uses "lifestyling", pension assets are shifted from equities into less risky assets such as government bonds and cash as the member of the pension plan approaches retirement age. The argument for such switching is that the member may become more risk averse as he/she approaches retirement and hence will wish to prevent unnecessary volatility of his investment holdings.

Lifestyling provides pre-determined investment selection from a range of funds offered by the pension scheme. It usually includes a series of automatic investment switches as the individual members approach their planned retirement date.

The objective of lifestyling is to target reasonable growth with a balance of safety and risk. It is generally aimed at members who do not take significant interest in their pension and select the default option (highlighted above) in the pension plan.

- **Hybrid plan**

Employers could also offer a hybrid plan to employees. This is a DB plan which incorporates features of a DC plan. The plan is funded by accumulating benefits based on employer and employee contributions. A minimum benefit may be provided to members based on years of service or average earnings and this is not dependent on the financial markets. Both the employer and employees will then also share the investment returns obtained from the pension fund assets. As a result, members could potentially expect to receive a smoother pension income over time, which is unlike the case for pure DC plans. ■