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Pensions in the Philippines - in urgent need of reengineering?

Michael Ferrer, Managing Director, ATR Asset Management, tells Hubbis about the teething problems with pensions in the Philippines.

MICHAEL FERRER
ATR Asset Management

THE PENSION INDUSTRY IN THE PHILIPPINES and its processes need a wide-ranging overhaul, according to Ferrer.

"In pensions, there's a lot of room for improvement," he says. "One needs to really look at the problems to come up with the right solutions to our pension system."

For Ferrer, there are three clear problems with the pension system in the country: that it's under-funded, there's no portability, and it's inadequate.

"A group of us have come up with some interesting suggestions on how we could address the current problems to avoid a crisis in the future," he reveals. "And what we've come up with essentially is to change the currently defined benefit pay-as-you-go system to a mandatory defined contribution (DC) system, which is funded, has portability, and which could address the issue of having enough pension when people retire."

When asked if PERA or the Personal Equity and Retirement Account, a retirement investment plan, has not addressed the problems he mentions, Ferrer mentions that it has nagging issues.

"PERA launched officially a year ago after ten years of being developed," he says. "And it is essentially a voluntary system where the theory is that with enough incentives, particularly tax incentives, people are going to be encouraged to save and invest for their future pensions."

"Unfortunately, I think most studies will show voluntary systems in the first place are complicated systems

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from the standpoint of accumulating assets, pension assets and encouraging people," he points out.

According to Ferrer, there are two issues for PERA in particular. "One is first the tax incentive is not much of an incentive today," he explains. "You've got a 5% tax refund or credit that they give you, while in other markets whatever you contribute to your pension account is shielded from taxes. We don't have that here."

Instead, only a small fraction that gets protected from tax. "Secondly, there are a lot of cumbersome requirements that make it difficult for people to set up PERA accounts," Ferrer states.

But there is a silver lining in that the infrastructure being built for PERA would be useful for the mandatory DC pension system.

"In other words, every private sector employee under a mandatory DC system would have to order PERA accounts to receive the contributions of companies into their pension accounts," he explains. "By doing that, you automatically create portability."

This is vital for the young generation which is prone to moving from one company to another, and thus they can bring their pension along with them. "It becomes funded because companies will be required to fund these DC accounts," he explains. "And third, it creates awareness among the employees, and among the public what are the features of a PERA account."

The hope, therefore, is that over-and-above what the mandatory DC system can provide, employees would be encouraged to contribute more to their PERA pension accounts and doing so, will save enough for their future retirement, Ferrer opines.

This is vital given that the average Filipino will not save adequately for their pension unless you force them to do so, says Ferrer.

"Current studies show that maybe around 2% retirees are financially prepared for their retirement," he says. "The rest have to rely on family or other forms of support. And a lot will have to continue working in retirement years just to support their lifestyles."

Ferrer points to what the Nobel Prize winning economist Richard Thaler said about the need to nudge people to contribute more to their pension accounts.

"In the Philippines, you need to push people, not just nudge them to set aside money for pensions," he says. "The good news is that it's still early days. We're a young population. But we need to do it now to avoid a bigger problem in the future." ■