Symposium Report

Demographic Change and Financial Services: a Short List of Threats – a Long List of Opportunities?

8th International Sustainability Leadership Symposium
27/28 September 2007
Swiss Re Centre for Global Dialogue, Rüschlikon

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Preface

Demographic change will be a key force in shaping the future in most industrial nations and will give rise to substantial and complex changes in society, business and politics. Experts expect average life expectancy to continue rising in the years to come, with significant consequences such as an increase in the number of elderly people, a declining birth rate and accelerated migration on the international labour market. As a result, demand for child-related services is likely to fall, while demand for services geared towards senior citizens, such as healthcare and lifelong learning, will continue to rise – to give just a couple of examples.

However, the specific impacts of demographic change on financial markets, the business opportunities for financial service providers and funded pension schemes are more difficult to predict. In anticipation of these challenges, the 8th International Sustainability Leadership Symposium was dedicated to the topic of "Demographic Change and Financial Services: a Short List of Threats – a Long List of Opportunities? Business Leaders, Policy Makers and Researchers in Dialogue". Some 140 participants gathered on 27 and 28 September 2007 at the Swiss Re Centre for Global Dialogue in Rüschlikon near Zürich to join in debate and consolidate the essence of current knowledge on the issue in a comprehensive, cross-regional and interdisciplinary manner.

The conference programme combined two approaches: Firstly, a macro-economic assessment, to illustrate the general effects of demographic change on financial markets and the financial services sector in the OECD context. And secondly, a micro-economic analysis, to identify the implications for the senior management and supervision of banks, insurers, pension funds and portfolio managers in different markets, with a special emphasis on Europe.

The present report summarises the symposium's keynotes, panels and working group discussions and draws some key conclusions from one and half days of stimulating debate. Through its publication we would also like to express our gratitude to all participants who actively contributed to an open, insightful and constructive dialogue.

Peter Forstmoser, Chairman
The Sustainability Forum Zürich

Ernst A. Brugger, CEO
The Sustainability Forum Zürich

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Input Paper[1]

Economic Impacts of Demographic Change – Challenges and Opportunities

Demographic change over the next 50 years will affect the world economy in many different ways and poses one of the biggest global challenges. Two major trends characterize demographic change in the first part of the 21st century:

- *Developed countries* are on the verge of entering the last phase of demographic transition, i.e. population ageing, marked by a massive increase of the population aged 60 and older.
- Many *developing countries* are in an earlier stage of demographic transition and are expected to face rapid population growth.

Economists analyze the aggregated effects of demographic change on consumption, saving, dissaving, and investments by the means of overlapping generation models. This paper describes the economic effects of demographic change in developed countries. It is a simplification of a scientific state-of-the-art report by Andreas Schäfer and Werner Hediger[2] and describes how demographic change will affect many aspects of developed countries' economies including sectoral production, labour and capital markets, public finance and retirement plans.

The overall effect on long-run economic performance will depend on time, extent and speed of demographic change and the age structure of the respective populations, as well as on the adaptability of the political and economic institutions. Therefore, from the current level of knowledge, it is unclear whether ageing will lead to a reduction of economic growth and a decline in living standards in developed countries or not. It is clear, however, that ultimately those will succeed who adopt a long-term perspective and are thus in the position of acting instead of reacting.

[1] Authors: Dr. Hans-Peter Burkhard and Dr. Erika Meins, CCRS Center for Corporate Responsibility and Sustainability at the University of Zurich

[2] Andreas Schäfer (CCRS and University of Leipzig – Institute of Theoretical Economics/Macroeconomics) and Werner Hediger (CCRS Center for Corporate Responsibility and Sustainability at the University of Zurich).

1. The Phenomenon of Demographic Change

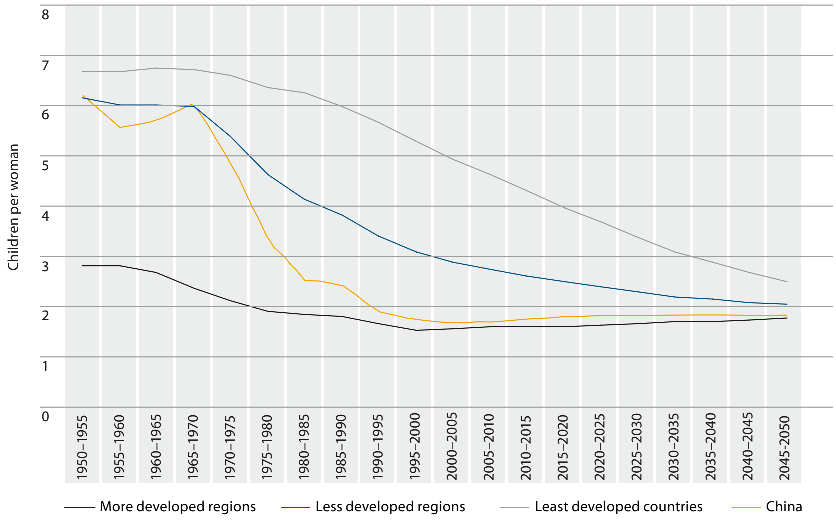
The term *demographic change* refers to changes in the age and structure of a population. Over thousands of years, the world population was growing slowly, if at all, and percapita income was nearly constant. Within the last decades of the 18th century, after the beginning of the Industrial Revolution, population started to increase at a rate unprecedented in history, due to a significant decline in mortality and an increase in fertility rates. However, birth rates did not continue to rise. The period following the Industrial Revolution was characterized by increasing percapita incomes and declining fertility rates. It was only interrupted by an increase in fertility rates shortly after World War II ("Baby Boom").

Today, in all OECD countries (except Turkey and Mexico), the current fertility rates are estimated to be at or below the level of 2.1 children per woman, the level which would be required for the replacement of a generation. In 11 OECD countries (including Switzerland, Japan and Germany), the estimated rate is even below 1.5 children per woman. Countries with traditionally high fertility rates, like Spain and Italy, belong to the group of countries with the lowest fertility rates in the world (1.2 in the year 2000).

A closer look at Europe reveals that two groups of countries can be distinguished: The first group with Mediterranean as well as Central and Eastern European countries is characterized by low fertility (fertility rates < 1.5) and population decline. In the other group including Scandinavia, France and Britain, fertility is recovering. Fertility rates in these countries are around 1.8. It is argued that this is due to policies and values enabling parents a good balance between life and work, i.e. flexible working hours and a good quality, state-subsidized child care system.

Figure 1
Past and projected development of fertility rates (medium variant)

Source: UN, Department of Economic and Social Affairs, Population. Division/World Population Prospects: The 2006 Revision.



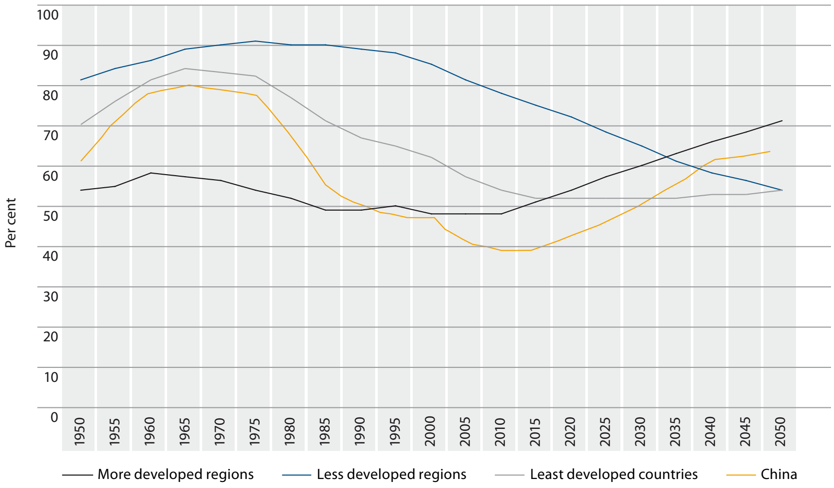
The fertility change in less-developed countries started only in the mid-1960s. It has been particularly rapid in East Asia. In the least developed countries, the process of fertility decline started later and from a higher initial level of fertility (see Figure 1).

The theory of *demographic transition* describes in a stylized form the relationship between countries' demographic change and economic development. The process of demographic transition is triggered by a leap in economic development and starts with a decline in mortality, followed by a decline in fertility, leading to an interval of first increased and then slower population growth. The last phase is characterized by population *ageing*. The speed and strength of demographic transition depend on and also influence many further variables, such as migration, health, political, and cultural issues.

The *dependency ratio* is the number of children younger than 15 and elderly people of age 65 and above in relation to the working-age population, i.e. people aged 15 to 64. A consequence of demographic change in developed countries is a high and increasing dependency ratio. In more developed regions, ageing will increase the dependency ratio from around 48% in 2000 to just over 70% in 2050 (see Figure 2). In Europe, there will even be almost one older inactive person for every working-age person.

Figure 2
Development of total dependency ratios between 1950 and 2050

Source: UN, Department of Economic and Social Affairs, Population. Division/World Population Prospects: The 2006 Revision.



2. The Economic Effects of an Ageing Population in Developed Countries

Developed countries are expected to experience an increase in their population aged 60 years and older in absolute and relative terms (see Figure 3). Even though the increase is strongest in developing countries, the expected increase in more developed regions from 64 million in 1950 to 325 million by the year 2050 is dramatic enough. It will affect many aspects of developed countries' economies: sectoral production, labour and capital markets, public finance and retirement plans. The overall effect on long-run economic performance will depend on time, extent and speed of demographic change and the age structure of the respective populations, as well as on the adaptability of the political and economic institutions.

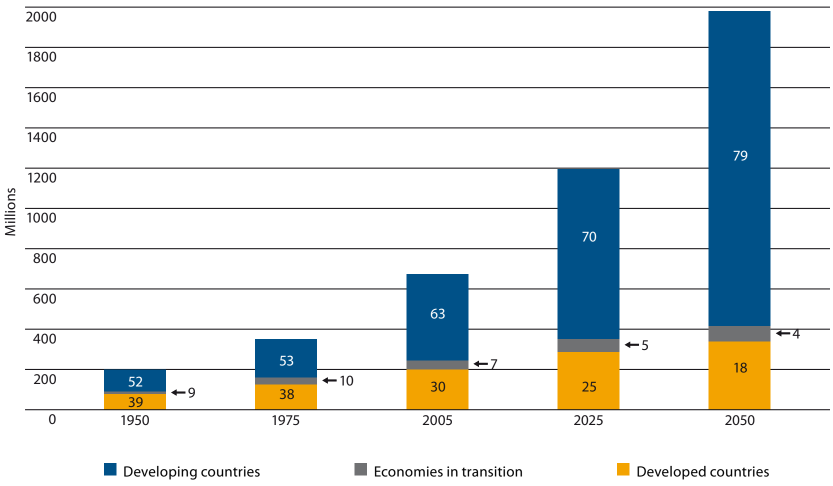


Figure 3
Size and distribution of world population aged 60 years or over by groups of countries[3]

Source: UN Department of Economic and Social Affairs, World Economic and Social Survey 2007: Development in an Ageing World, New York 2007.

2.1 Shifts in Demand

Thesis 1:
Ageing affects sectoral production by triggering substantial shifts in demand and supply.

Due to different time budgets, health status, responsibilities, and incomes after retirement, the consumption behaviour of retirees differs substantially from that of younger generations. Therefore, an ageing society causes shifts in the aggregate demand structure and induces alterations in the sectoral production structure of the economy.

The main impacts include increasing demand of health services and pharmaceutical products as well as more and different demand of services in the leisure and travel sector. Impacts are also to be expected on the housing industry, the financial sector, public infrastructure, and the food sector.

[3] Note: (1) The graph shows estimates (until 2005) and medium-variant projections (after 2005).
(2) Percentages are shown inside the bars.

Shifts in the demand for education are to be expected as well: The declining size of the younger population will, firstly, decrease the demand for basic education and, secondly, call for a higher education for the ones who remain. Finally, because people will be likely to work up to a higher age and will, in general, have to meet higher requirements, the demand for further education will increase.

Thesis 2:
Shifts in demand and supply trigger shifts in investment structure.

Long-term shifts in the sectoral production structures will require equivalent long-term shifts in the investment structure, private as well as public. Accordingly, specific investment opportunities will arise in health services (intensive medical care, assisted living, meals and nursing care delivered at home) and the pharmaceutical sector, housing industry, leisure and travel sector, educational sector, and the food and beverage sector.

The financial sector in its role as a financial intermediary will follow and support these shifts in the real economy by adjusting supply and demand on capital markets.

2.2 Labour Force

Thesis 3:
The relative size of the labour force will decrease in many countries and may lead to increased global migration.

Within the OECD, the share of the old-aged population is expected to double, on average, over the next 50 years. This demographic effect goes along with a trend towards earlier retirement and the arrival of the baby boom generation at retirement age. The overall effect is a large and rapid increase of the dependency ratios in most developed economies. At the same time that the size of the labour force will, in relative terms, diminish significantly, the labour force in most developed countries will also experience a decline in absolute terms. Skilled labour will become increasingly scarce and companies will face higher costs for skilled labour.

It is argued that increasing immigration can solve the problem. However, a declining population would require immigration at an increasing rate. This is impeded by the fact that the global reservoir of specialists willing to emigrate is limited. In addition, societies' capacities to integrate immigrants are limited too. In sum, compensation through increased migration can alleviate the problem of a shrinking workforce, but not solve it.

Thesis 4:
Demographic transition affects productivity of labour force.

Ageing affects the productivity of a labour force. Size and direction of the effect, however, are unclear, since some of the effects point in opposing directions. Medicine, psychology and gerontology conclude that cognitive and physical capabilities decline with age, which implies declining productivity. Economists, on the other hand, argue that productivity depends on experience and therefore increases with age. It seems that not the age of individuals but the age composition of a team is relevant for its productivity, since younger and older employees are complementary rather than substitutes. In able to benefit from this arising opportunity, adaptations of employment conditions are necessary at the legislative as well as at the individual company's level.

2.3 Capital Markets and Economic Growth

Thesis 5:
Fast-ageing countries will see large declines in savings.

Since individual saving behaviour varies along people's life cycle, ageing will particularly affect the aggregate savings rate. Younger people typically consume their incomes and invest in human capital, whereas middle-aged people also accumulate savings and invest more in physical capital. Elderly people typically start dissaving after retirement. The fastest-ageing countries – such as Japan and to a lesser extent other industrialised countries – could see large declines in aggregate savings and a deterioration of their current account position as the elderly in retirement run down their assets. This effect may be lessened by older people's aim of bequeathing money to the next generation.

Thesis 6:
Ageing will not inherently lead to an economic slowdown.

From a macroeconomic point of view, the most crucial factor for economic growth is capital accumulation; that is, investments in productive assets, including human capital as well as R&D. Ageing may affect capital accumulation and will, in fact, lead to conflicting tendencies for economic growth.

On one hand, the large declines in savings rates in most developed countries will induce a decline of the capital available for investments and ultimately exert downward pressure on economic growth. In addition and ceteris paribus, a relatively smaller labour force will amplify the effect. On the other hand, new evidence from endogenous growth models suggests that ageing could increase incentives to invest more in human capital and thus foster economic growth in the long run. Therefore, the overall effect of ageing on economic growth will depend on the scope of these developments, as well as on the framework set by economic policy.

Thesis 7:
Ageing will not inherently lead to an economic slowdown.

Since return on capital is higher in developing countries with higher economic growth, many investments flow there currently. Once dissaving starts and the available capital for investments becomes scarce in developed countries, rates of return on capital will increase and a reimport of capital will occur. The financial sector in its role as a financial intermediary will follow these developments and adjust the global supply and demand of capital.

Thesis 8:
A decumulation of baby boomers' assets may induce an asset market melt-down.

The retirement of the baby-boom generation and its beginning of dissaving will reduce the demand for assets and thus may cause asset prices to fall. Although not backed by empirical evidence, some experts fear that the expected decumulation of baby boomers' assets and the implied decline in rates of return on capital could induce an asset market meltdown.

2.4 Public Finance and Retirement Plans

Thesis 9:
The pressure on public finance will increase.

Ceteris paribus, a declining labour force will reduce total income and thus tax revenues. At the same time, governments will face changing demands e.g. for health care services, public transportation, or education. In sum, these two effects will raise the costs per person of publicly provided goods and call either for a reduction of the services provided by governments or an increase of the per capita tax burden. Where governments chose to withdraw from the provision of goods, opportunities arise for private suppliers.

Thesis 10:
Ageing necessitates reforming retirement plans.

A major problem and issue of concern involves the provision of income to the elderly. Where retirement plans are based on a transfer system, fundamental reforms are necessary. In countries where retirement is based on a funding principle, reforms are mainly necessary if defined benefit plans prevail (versus defined contribution plans). Such reforms are aggravated by the fact that they are likely to have distribution effects by reducing the income of some generations. Retirement plans with defined contribution plans will require more real resources to be accumulated today in order to meet the needs of the longer-living retirees in the future.

3. The Challenges and Opportunities of Demographic Change for Economic Development

As both growth-enhancing as well as growth-retarding effects are likely, it is unclear whether ageing will really lead to a reduction of economic growth and a decline in living standards in developed countries as expected by some. It is clear, however, that ultimately those will succeed who adopt a long-term perspective and are thus in the position of acting instead of reacting. Last year's Symposium provided ample guidance for the adoption of long-term strategies.[4]

For business, demographic change is a prospect with many new opportunities. Demand for new products and investments will evolve in the health, pharmaceutical, leisure and housing sector, to name just a few. Higher investments in human capital as well as in R&D are key factors for success.

For developed societies as a whole, ageing poses many challenges. Major issues include reshaping the retirement system, providing adequate public infrastructure and services, creating an appropriate framework for immigration, and adjusting the educational system.

The role of the 8th Symposium is to specify how to deal with the imminent challenges as well as to identify the emerging opportunities and how to grasp them in a sustainable way.

[4] "From Short- to Long-Term: Who Cares?": 7th International Sustainability Leadership Symposium.

Atsushi Seike, Keio University, Tokyo
Demographic Change and Future Labour Markets: Towards a Life-Long Active Society

"The dramatic change in the population pyramid requires us to change our social system. In order to cope with this enormous ageing of the population in Japan, it is very important to promote the employment of older people. If older people continue to work beyond the current retirement age, this will help our societies tremendously: it will ease the burden for our social security premiums per capita and increase human capital input to our economic activities. So it is very important for us to utilise the human capital of older people who have the willingness and the ability to continue working. I think that in this respect Japanese society has an advantage: a large number of older Japanese people are highly motivated to carry on working even after the age of 65. ... In Japan, labour force participation as a proportion of the total population willing to work is still more than 70 per cent, whereas, for example, in Germany it is just above 30 per cent and in France less than 20 per cent.

We need to take advantage of this high motivation among older people to participate in the labour market. The problem is that there are still some institutional obstacles that prevent us from utilising the human capital of older people. These institutions were established when there was a pyramid-shaped population. One problem is the public pension system, which has some disincentives for older people to continue working. Also, mandatory retirement is still legal in this country, and the majority of private corporations still keep such practices. To some extent, these two factors inhibit labour market participation beyond the official retirement age.

In order to extend the employment of older people, we need to revise wage systems as well. Most Japanese corporations have a so-called seniority-based wage system, in which wages increase with the length of service or with age. Without a substantial adjustment of this system, an extension of the retirement age or increased employment of older people simply brings you higher labour costs. So in order to extend the retirement age, it is very important to smoothen the seniority-based wage system, which means making the wage profile flatter."

Stefan Bichsel, Lombard Odier Darier Hentsch

What Does Demographic Change Mean for Pension Plans?

"What does demographic change mean with regard to pension plans? Today the ratio between those who are retired and those who are working is one to four, but in 2050 it is going to be one to one. This tells us that the generational contract in its present form will no longer work in the future. What does this mean in practical terms? It means that we have to rebalance the solidarity issue and that we have to introduce more individual responsibility. I believe that, when we talk about solidarity, it is important to distinguish solidarity between generations from solidarity within the same generation. There may still be some room for solidarity within a generation, but between generations it will be hard stretched. If you are 20 years old today, the prospect of financing a one to one situation is not very inspiring. Therefore, we need to speed up the reforms that have already started, albeit in a timid way. Obviously, these reforms are unpopular by definition because we have to tell people that they certainly need to work longer – possibly for less. There will also have to be a shift from defined benefit pension plans as they have traditionally been in place to defined contribution plans, with a parallel shift from collective approaches to much more individualised saving schemes.

Current legislation enhances a kind of security or insurance thinking that is not optimal in the long run. If you look at the European Pension Directive, this almost creates a monopoly for the insurance industry, which I feel is wrong. It does not help the people who require help. The more you move away from defined benefit to defined contribution schemes and from collective to individual approaches, the more important asset management becomes and the less insurance is important. As you build up your assets in the second and the third pillar while you work, an insurance element is in fact necessary to provide protection against the mortality and disability risk. And, of course, the longevity risk needs to be tackled as well. Once you hit retirement age, though, the goal should be to go on managing the accumulated money as smartly as possible in the light of one's needs, in contrast to an annuity exercise that offers a lot of security but is bound to produce sub-optimal returns. So asset management has an important role to play, and it is up to the regulators to increase the possibility of competition among the various financial services providers for the benefit of the future pensioners.

What should be done? Perhaps we should say that people actually have an obligation to contribute to the second and the third pillars, so we should go from a voluntary "opt-in" to an "opt-out" approach – which means that people need to be in the system unless they make a deliberate decision not to be in it. ... There also have to be tax incentives to make sure that people find this attractive. ... And then, of course, we need to assist the households because they will have to be much more active in managing their assets. So I think it is important that the information they receive on pension-related products is actually understandable, simple and transparent. There has to be better advice; this is still not at the level it should be and poses a challenge. Finally, a crucial point is that financial education needs to start early on. We see that there is a major lack of understanding in this area; we learn everything in school except finance."

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Panel 1

Stefan W. Schmitz: "The asset meltdown hypothesis is not even worthwhile being tested empirically. It is based on a totally flawed conceptual framework."

Introduced by moderator Ernst A. Brugger, Stefan W. Schmitz (Austrian Central Bank, OeNB) first made a comment on the asset meltdown hypothesis. He maintained that this is so conceptually flawed as to be unworthy of empirical testing. In essence, it says that long-term asset prices and long-term interest rates are determined by relative savings rates in the household sector. However, none of the three relevant interest rate theories of economics (the pure time preference theory, the Keynesian liquidity preference theory and the Neo-classical loanable-fund theory) support this. In order to think about the future path of long-term interest rates, it would be necessary to take into account both the savings rate and investment. On this basis, two opposing trends can be identified: a growing share of dissavers would reduce the supply of savings and thus lead to an increase in interest rates.
At the same time, there is downward pressure on interest rates, however: if the labour force shrinks in size, capital will be substituted for labour, driving down the marginal productivity of capital. Simulations by Stefan W. Schmitz himself and many others suggest that long-term interest rates will decrease as a result of ageing.

Second, Mr. Schmitz criticised the "bashing" of public pension systems. A more meaningful dependency ratio would look not at age groups but at the number of economically active vs. economically non-active people. This total dependency ratio was already 100 per cent in Austria in 2004 and will only increase to 108 per cent by 2050, a very marginal rise. This would mean that public pension funds can in fact be financed provided that the political will to support elderly people is there.

Stefan Bichsel: "In the first pillar there should probably be a pay-as-you-go system and some solidarity, whereas in the corporate and the third pillar we should have more individual responsibility, meaning that people should build up their capital."

Invited to explain why funded pensions would benefit retired people when interest rates are going to fall in any case, Stefan Bichsel replied that in a pay-as-you-go system a reasonably healthy relationship is required between those who pay and those who receive the money. Since demographic change will throw this relationship into total disequilibrium, the current system is not sustainable and should give way to a funded system, in which individuals build their own capital. He repeated the point made in his keynote, however, that solidarity should be reinvented not abandoned: so the first pillar should retain a basic pay-as-you-go system, while in the second and third pillars individual responsibility should be strengthened.

Atsushi Seike: "It is very important for us to narrow the gap between the relatively high motivation of older people to continue working and employers' reluctant attitude towards employing older people."

Professor Seike was asked by Stefan W. Schmitz whether he was actually advocating coercion to keep older people in employment. But rather than that, he emphasised the need to narrow gaps between older people's motivation to continue working and employers' attitudes. Such gaps are caused by the seniority-based wage system, which means that employees need to lower their wage expectations. There are also skills mismatches because the majority of jobs are now in the service sector, while many older people have developed their skills in the manufacturing industries. For this reason, retraining programmes are becoming increasingly important.

Financial Services Providers' Challenge in Dealing with Shifting Demands and Supplies

Hans-Jürgen Wolter, Swiss Life

"When it comes to a fully funded system, you have a forced long-term savings process that takes funds away from short-term consumption. You have impacts on the financial markets. I give you a very simple example: annuities need to be covered by long-term fixed-income instruments and this of course has an impact on long-term yields. We typically talk about a regulatory environment – do not forget that – which has an impact on the investments as mentioned before. So it is really important that the regulator keeps in mind the effects that the regulation has on the investments. But there are also impacts on the product side, since the insurance industry is definitely moving towards long-term guarantees rather than short-term guarantees. But just looking at the second pillar in Switzerland, here we still have a short-term guarantee that has to be met each and every year. Again, we talk about a political process; whether that makes sense is a different question. Given the regulatory environment, there is a clear tendency to move away from decentralised production to a more centralised approach, while in the past the life insurance and the pension markets were definitely split and done separately in each and every country. … In the past, we also had a situation where production and distribution were basically done as part of the same operation. So the insurance company was not just the producer of the insurance contract but also the distributor. That has definitely changed and will change further."

W. Weldon Wilson, Swiss Re

"The issue we face with new insurance products meeting the demands of an ageing population is that they are very complex and some of their risks are correlated in ways that you might not consider. They are not all just dependent on straight insurance risks. It is not purely about "What is life expectancy? Where is longevity going?" You tie in interest rate risks, equity market and inflation risks and it makes these difficult products to manage. For dealing with longevity risk the key is asset liability management. But we are frequently discussing how to match these risks over a thirty year period. Are the financial products out there? At this time, no, they are not out there in size.

To make this work, we need some financial innovation. It will be necessary to take the insurance risks and to see what can be moved to the capital markets. There will be, and already is to some extent, the ability to hedge longevity risk. Can you combine mortality risk with longevity risk and take that to the capital markets with securitisation? We have seen securitisations of mortality risk through extreme mortality events – the cat bonds for mortality – and we have also seen it to monetise embedded value. There is great interest in this in the financial markets and this is where I think the market will be going because it should result in reduced volatility. When undertaking these securitisations, the key issue is: what is the volatility related to mortality? If you can combine some of the longevity risk, selectively package risks, so that you have pensions obligations for the current lien payout and you tie that to older-age insurance policies, it should be an attractive product.

Ultimately, given the size of the issue you cannot expect one industry to tackle it alone. It cannot be just the banking industry or just the insurance industry. I think it is going to involve combinations and going to the capital markets to effectively spread the risk and ultimately manage it."

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Secretary General, The Geneva Association

Panel 2

Patrick M. Liedtke: "Longevity is not just another trend, it is truly not. In human history you can go back over centuries, over millennia: we have never had shrinking populations, save for very concrete catastrophes – plagues, wars and other disruptions – but not as a normal continuation path of the development on this planet."

The second panel discussion went off to a lively start with two thought-provoking remarks from Patrick M. Liedtke of The Geneva Association. First, he argued that absolute fertility rates are in fact completely irrelevant for dependency ratios. For example, if there are 200 people in generation one and 100 in generation two, this means a dependency ratio of 2 : 1 and a fertility ratio of 0.5. If nothing changes, there will then be 50 people in generation three, leaving both indicators exactly identical. Actually, Mr Liedtke said, high fertility rates would cause major problems to Western countries today because on top of high old-age dependency ratios there would then be high youth dependency ratios as well.

A second comment was directed at Hans-Jürgen Wolter, who had called longevity "just a trend in life expectancy" in his speech. Bearing in mind that the current period is the first phase in human history with shrinking populations (except for very concrete catastrophes), Mr. Liedtke said, it is anything but just another trend. Hans-Jürgen Wolter replied that he was simply referring to the way in which longevity is modelled by actuaries. However, such models also involve the notion of longevity risk because in reality there will be a deviation from the trend.

Stefan Bichsel: "It is not a question of maximising everyone's return but one of disentangling the issues: what is the insurance part, what is the asset management part? What risks are you able and willing to take and then you will get your appropriate solution."

Patrick M. Liedtke also took issue with Stefan Bichsel's argument that retirement systems should shift away from a protection/insurance approach to one that tries to maximise asset returns. The Capital Asset Pricing Model (CAPM) says that this comes at the price of higher risk and he for one would prefer zero risk over better returns in his own old-age investment. Stefan Bichsel welcomed this comment, saying that this kind of analysis of one's actual needs and preferences is exactly what he had in mind. Reforming retirement investment is not about maximising everyone's returns but about individuals disentangling the insurance part from the asset management part and then getting the appropriate solution. In contrast, under the current system everyone is in some collective pot and has no transparency of risks and costs.

Hans-Jürgen Wolter: "What you have to keep in mind is that, typically, it is not the regulators that define the frameworks. They just execute it to a certain extent. Who you really have to convince on the issues are the players in the political system."

The panel was then opened to questions from the audience. One participant expressed scepticism on the effectiveness of the remedies put forward in the discussions, arguing that there are limits to working longer and that more self-reliance is not going to work because a large number of people do not have sufficient assets in the first place. Governments would have to educate people much more on these challenges, he went on, but full disclosure is not in the self-interest of politicians. Replying to this comment, Hans-Jürgen Wolter argued that setting up a workable system should distinguish between securing funding for the future and addressing the legacy issue of gaps in the current social security system. Weldon Wilson stressed the importance of political will, since unpopular steps such as redistribution and forced saving may prove unavoidable. Finally, Patrick M. Liedtke contradicted one of the points made by the participant, arguing that working longer can in fact ease pressure on the system.

Weldon Wilson: "It is an issue of political will. Do we have the fortitude to say that we are going to take pension benefits away from those who have invested wisely or have other resources, reduce their state pension in order to help fund others?"

Wrapping up the panel, moderator Ernst A. Brugger wanted to know what the industry or individual companies are doing to have a dialogue on these issues with regulators. While Patrick M. Liedtke explained that the Geneva Association is not a lobbying but a research organisation, Weldon Wilson suggested that Swiss Re is well organised to share knowledge with regulators and the industry, for example through publications on key concerns. Hans-Jürgen Wolter pointed to the work carried out by the industry association in Switzerland and reminded the audience that frameworks are ultimately determined by the political system not by regulators.

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Parallel Working Groups I

A. Does an Ageing of Mature Markets Boost Emerging Markets?

Introduction: Geoffrey Wood, Cass Business School
Challenger: Stefan W. Schmitz, Austrian Central Bank (OeNB)
Moderator: Stefan Flückiger, Swiss Delegation to the OECD

Geoffrey Wood examined the working group topic in terms of financial markets. According to the "life-cycle" hypothesis of economics, people save less as they get older. Since the main task of finance is to allocate the existing stock of capital plus savings, it seems inevitable that financial markets are going to decline in developed countries due to ageing. Yet, Professor Wood argued that this conclusion is wrong, because of a crucial difference between banking and market finance in terms of their use of information. Banks need to be close to their clients since they base their decisions on private information. Markets, however, are independent of where the users of funds are located because they make use of public information. Interestingly, the current direction of net capital flows is from developing countries to developed countries. There are two reasons for this: A lot of the capital invested in mature markets (especially in the U.S.) comes from China, which is not only a developing country but an ageing society at the same time. Like other countries with ageing populations, China currently has high instead of low savings rates. The resulting surplus capital flows to developed countries because these have mature financial markets with high governance standards. Challenger Stefan W. Schmitz added a couple of comments on the link between ageing and the direction of capital flows: first, with internationally diversified wealth management, capital exporters tend to run a current account surplus in the accumulation phase and a corresponding deficit in the decumulation period. Second, demographic change in many emerging markets will lead to an improvement in their current account balances over the next few decades. Stefan W. Schmitz stressed, however, that any demographic effect on capital flows is outweighed by the impact of economic policies in emerging markets increasing the productivity of capital. The working group concluded that continued economic development in emerging countries depends less on external factors such as ageing in developed countries and more on strengthening framework conditions for local financial markets and the productive economy as a whole.

B. The Innovation Drive for Pension Funds: The Impact of Demographic Change on Strategic Asset Allocation

Introduction: Peter Bänziger, Swisscanto Group
Challenger: Beat Zaugg, Watson Wyatt
Moderator: Alexander Barkawi, SAM Indexes

After briefly summarising the causes of ageing populations, Peter Bänziger illustrated the difficulty of restructuring a mature fund (with higher payments than earnings) suffering from underfunding, i. e. a cash ratio of less than 100%, by comparing it to an immature fund (with higher earnings than payments). Key conclusions that can be drawn from this analysis include: liquidity requirements necessitate an active reduction of assets, return estimates on the basis of historical figures are unacceptable, a pure risk/return view is insufficient, a cash ratio floor needs to be defined and retaining scope of action is essential. Translating these findings into possible investment concepts, Peter Bänziger focused on four aspects: 1)

liquidity-driven investments, 2) dynamic investment strategies (portfolio insurance), 3) use of derivatives to hedge against excess losses, and 4) optimisation of maximum setback risks. He then took the audience through two possible investment strategies combining six asset classes in different ways, emphasising, however, that there is no standard solution. Strategies need to be tailored to the individual situation of each pension fund, which requires closer co-operation between pension fund and investment experts. Challenger Beat Zaugg agreed with the majority of these arguments but expressed some reservations on liability-driven approaches because of the negative effect of liquidation on long-term investment. The dominant view in the group discussion was that demographic change places strong constraints on asset allocation but that existing research on its impacts is not fully used yet in pension fund management. Peter Bänziger was confident, though, that this is about to change.

C. The Innovation Drive for Real Estate

Introduction: Paolo Vanini, Zürcher Kantonalbank
Moderator: Oliver Schelske, Swiss Re

Innovative activity has recently picked up speed in the real estate asset class, mirrored by the development of structured products, implicit pension debt (IPD) deals, index-linked mortgages, funds and index-linked saving. Paolo Vanini set out to examine whether some of these innovations offer beneficial risk and return profiles from a demographic change perspective. Defining the key threat of demographic change as a collapse or major changes in the first and/or second pillar of the Swiss retirement system, he described three products suitable for three basic customer types with differing needs: 1. double income, no kids couples ("dinks"), 2. families with children and 3. less wealthy people. For home-owning dinks, a reverse mortgage would allow to convert the equity of the home into income, without the need to repay the loan before the sale of the house or the owner's death. Because of tax reasons, however, these products do not usually pay off in Switzerland, in contrast to the United Kingdom, for example, where they are well established. For families with children, a real estate index-linked mortgage insures the invested capital against a downturn in house prices, by combining a traditional mortgage with a put option. For less wealthy people, real estate index-linked saving products offer a hedge against falling interest rates and/or rising house prices and can be used to diversify savings. Thus, a number of products addressing demographic change risks do exist today, but Paolo Vanini pointed out that innovation is hampered by the multitude of regulatory bodies, whose interventions in the marketplace are in general not well coordinated. Another, more fundamental, challenge is posed by the difficulty to predict how the market will develop beyond a time frame of three to five years.

D. Impacts of Demographic Change on Financial Service Providers: Market and Managerial Issues

Introduction: Patrick M. Liedtke, The Geneva Association
Moderator: Jacqueline Coté, World Business Council for Sustainable Development

In Patrick M. Liedtke's view, demographic change is one, if not the, key driver of economic and social change in the coming decades and will have a direct impact on financial service providers. It is accompanied, however, by other trends that will further reinforce themselves: globalisation and market convergence, increasingly international regulation, the intensifying public-private debate and the incursion of other players, especially in life insurance. It is against this background that the industry will have to address challenges in the two key areas of markets (i.e. products) and management (i.e. production). With regard to markets, an ageing population will require different products but will also have to take on more individual responsibility. However, many potential customers lack adequate financial literacy, while the (insurance) industry in turn needs to learn more about the "new old", so it can offer them the right range of products. With regard to management, the key challenge for the industry will be to respond effectively to the changing age composition of the workforce, by gearing their human resources management much more to retaining and recruiting older employees. The ensuing discussion was rather critical of the industry as a whole, drawing attention, amongst other things, to its insufficient customer focus and slow response to the employee challenge but also to weaknesses in product design, such as complexity, high costs and overly optimistic market assumptions. The industry was urged to become more active in embracing the challenges created by ageing populations and work together with governments and the public to create a more transparent marketplace.

E. Will Older Generations Dominate the Future Rules of the Game?

Introduction: Andreas Reidl, Stiftung Dialog der Generationen and A.GE Agency for Generation Marketing
Challenger: Prisca Boxler, World Demographic Association
Moderator: Sandra Hedinger, Swiss Life

Andreas Reidl started his presentation by citing a study published in 2006 by Booz Allen Hamilton that forecasts profits of German banks and insurers to shrink by up to 25 per cent as a result of ageing and consequently calls for innovative business models. Demographic trends in Germany, Austria and Switzerland clearly show that the share of people aged 55 years and more will rise quickly, while that of younger people will decrease. The increasing gap means that the largest potential for growth indeed exists among older target groups. Mr. Reidl emphasised, however, that all industries will have to rethink their products, their marketing and their distribution channels if they are to benefit from these opportunities. In marketing, it will be necessary to think about customer value instead of "senior citizens". Markets are likely going to become more specific and companies need to find out what this customer group really wants. Four possible communication strategies could be: old but active, old but competent, old but living a lifestyle plus old and young living together. Challenger Ms. Boxler made one major comment. In her view the over-55 age group is diverse in itself: on the whole, today's people aged between 55 and 75 are the fittest and most skilled ever, so adapted products may only be needed for those over 75 years old. In the discussion, a point drawing particular interest was the link between older people's attitudes and sustainability issues. Mr. Reindl warned that caring for one's grandchildren should not be equated with caring about living conditions for future generations in general. It was also argued that the whole concept of solidarity between generations should be redefined in view of vested interests and political inertia. Ms. Boxler pointed to some promising policy initiatives in this respect, for example the generation agreement in Norway and the pension policy in New Zealand.

Nicholas Eberstadt, American Enterprise Institute
Societies in Transition: Considerations on Different Markets and Regions

“What we see is that the demographic contribution to the world economy will be very different in the next generation from the generation that we have just gone through. Let me discuss a little bit of this here. First, let us take a look at the prospective change in working age population in the global labour force. Over the two decades under consideration, the pace of labour force growth for the world as a whole will be distinctly slower than in the previous generation and the absolute size of labour force growth for the world will also be smaller. There will be a shift in the global composition of labour force growth. Almost one third of the prospective labour force growth for the world over the next 20 years will be in sub-Saharan Africa. Between sub-Saharan Africa and the Indian Subcontinent – India, Pakistan and Bangladesh – we will be considering almost two thirds of the prospective labour force growth. In most of the traditional developed markets, as you know, the absolute size of the labour force will be shrinking. The situation is even sharper if we look at changes in the younger labour force – people from the ages of 15 to 29. Between now and 2025, there will be almost no growth in the total numbers of younger people in the world, about 90 million as a whole. All of that change will be in sub-Saharan Africa. And in other important areas of the world economy – not just the developed countries but also China – there stands to be a dramatic drop in the number of younger, and presumably better trained, new prospective workers. Most of the world’s growth in labour force will be among older potential workers, people in the 55 to 69 group. The greatest single contribution to the overall potential labour force is for China: China is going to have a surge in potential older workers.

Let me talk for just a moment about the situation in Europe. In addition to the question of the pensioner burden, there is of course the question about the ageing of the labour force. What we have seen over time is the exit of people from the labour force in Western Europe in increasingly dramatic numbers. The current generation of older workers is the healthiest and best educated cohort of such people that the continent has ever seen. They also participate less in the workforce than any previous generation of Europeans at that age. ... The question for Europe in the future is whether older workers can be encouraged to continue to participate in the labour force. The participation rates for people between the ages of 55 and 64 have a very strong influence on the effective retirement age for the society as a whole. It is the 55 to 64 group that is key in taking advantage of healthy ageing for Europe. But of course, as you know much better than I do, there are many policies in place in Europe today that discourage people between 55 and 64 from continuing to participate in the workforce. Pension laws are just one of these impediments. There are others: labour regulations, educational approaches, healthcare policies and all of the rest. But the prospect for Europe’s workforce growth will not be as gloomy as some have said if the older working population can be encouraged to continue working just a little bit longer.”

André Laboul, OECD & International Organisation of Pension Fund Supervisors (IOPS)

International Regulatory and Policy Responses to Demographic Change

“Annuities will be extremely, extremely important in the future, as we all know, and insurance companies will play a major role here. I am not saying that annuities will be the only product, but they will be a key product in the future, and still they are underdeveloped. This is quite surprising because the impact of the baby boom will arrive very soon. Things are changing but there is still a lack of awareness among policy makers. Of course, we know all the problems – the pricing, adverse selection related issues, the problem of matching assets and the lack of sufficient financial instruments to match assets, the complexity of the product, the lack of understanding and regulation (for instance with regard to the tax-saving lump sum in several countries). Solutions are not obvious and may entail policy actions like mandating tax incentives and developing proper financial instruments to match annuities. But I think, as recently underlined by Jeffrey Brown (Professor of Finance at the University of Illinois), a better understanding is maybe the key to further develop this market, which is really ill-understood as Franco Modigliani (Nobel-Prize winning economist) already said two decades ago.

The shift to defined contribution schemes eases the pressure on defined benefit schemes and contributes to the general objective of risk diversification. The introduction of investment choice a is a logical response to the shift of market risks but – and this is a big but – the reallocation of risks away from companies to individuals raises serious concerns on the capacity of individuals to protect themselves adequately in the absence of proper financial education and consumer protection. This is a very important issue, which is not only related to the difficulty of choosing between the different investment instruments but also to the level of contributions. ... But financial education is clearly not enough, because of people’s myopia and passive behaviour – the fact that when individuals have to make choices, they usually do what is easiest, which may often mean doing nothing. So there are other solutions: automatic enrolments and default mechanisms, which shift the option from opt-in to opt-out, though this has its own drawbacks. And fraud and mis-selling need to be addressed as well! But clearly financial education is only part of the system. It needs to go together with regulation, with further disclosure and information, with work in behavioural economics.

There is clearly no consensus on the asset meltdown hypothesis, and if there were any consensus, it would be to say no: the asset meltdown will not happen. We may have a gradual dissaving with limited impact. In fact, we may even have an actual rise in financial asset prices. What we are more or less sure of is that we will have a shift from equities to bonds, that behavioural assumptions will be key, along with the role of annuities markets, regulation – sometimes regulation may just prohibit lump sums –, bequests and international demographic arbitrage involving developing countries, and so on.”

Panel 3

Geoffrey Wood: "If we are going to shift risk to private individuals, we do indeed need to improve financial education. The problem with this is that the level we are starting from is astonishingly low."

Professor Geoffrey Wood of the Cass Business School launched the final panel discussion. Referring to André Laboul's point on the underdevelopment of annuities he said that he did not find this very surprising. Demographic forecasts are not fully reliable and relatively small deviations cause enormous problems for insurance products such as annuities. In this context, he reminded the audience of the fundamental difference between risk and uncertainty. Risk can be calculated on the basis of known probabilities; uncertainty cannot and results in inefficient pricing. Similarly, funding gap calculations are sensitive to assumptions and therefore must be met with care. Concerning the shift of responsibility to individuals, he also called for better financial education but warned that the current level is 'astonishingly low'. Finally, Geoffrey Wood urged governments not to pursue, or to abolish, contradictory policies that create perverse incentives for individuals.

Herbert Lüthy: "If every change in the conversion rate needs to be decided by politicians, we of course have the danger – which is what we see today – that they do not dare to do so because this would make them unpopular."

Herbert Lüthy also started with the annuities market. Echoing Professor Woods' analysis, he drew attention to the persistent underestimations of life expectancy in the past, which have made insurers cautious of the product. Next, Herbert Lüthy listed some necessary reforms in Switzerland: a) differences in regulation for pension funds and insurers should be eliminated unless there are concrete arguments to the contrary; b) care should be taken that regulatory requirements, for example on reserves, do not encourage pro-cyclical behaviour; and c) decisions on fundamental elements such as conversion rates and interest rates should be made according to guidelines defined in the law, not by politicians on a day-to-day basis. Lastly, Herbert Lüthy expressed strong support for improving financial knowledge, not just of the populace but of politicians, too.

André Laboul: "The financial industry is sometimes better placed than governments to assess the importance of these issues. This is why we really try to work together and have very close relationships with governments."

Responding to these comments, André Laboul said he was in full agreement with the main points made. With regard to annuities, he added that in some countries part of the problem is a profound lack of awareness among policy makers, beyond the technical difficulties. And concerning differences in regulation for pension funds and insures, he pointed out that the OECD is currently running a project on this to produce "solid arguments".

Led by moderator Markus Koch of PricewaterhouseCoopers, the discussion then shed more light on the key challenges and possible steps forward. All panellists agreed on the absolute necessity to raise awareness and improve financial education. As Herbert Lüthy pointed out with regards to Switzerland, large parts of the population still live in a state of denial, negating the existence of a funding gap. It would be the responsibility of politicians to press home the issue, but the panellists voiced doubts about their likelihood to do so. Often they do not seem to fully understand pension-related problems, which is why educational efforts should also target politicians. But as both Herbert Lüthy and André Laboul stressed, even when politicians do realise the need to act, they often tend to avoid the unpopular decisions that are necessary. A better educated population would put them under more pressure to 'grasp the nettle'. Geoffrey Wood added that aligning politicians' incentives with those of the general population would also help the cause.

In view of these challenges, a plea was made to the insurance and pension fund industry to be more active in raising people's awareness. André Laboul underlined that the promotion of dialogue and partnership between the industry and governments is, along with improving financial education, one of the OECD's top priorities.

zürich
Hans H.P. Groth

Parallel Working Groups II

F. Country-Specific Age/Health Patterns: Options for Achieving Sustainable Prosperity

Introduction: Hans H. P. Groth, Pfizer Switzerland
Challenger: Jean-Michel Chatagny, Swiss Re
Moderator: Thomas Scheiwiller, PricewaterhouseCoopers

According to Hans H. P. Groth, the ageing of societies changes everything and affects everyone. Chiefly caused by extraordinarily successful economic development and public health achievements, it may be the most significant revolution created last century but will require comprehensive reforms this century to address its fiscal, financial and labour market implications. Statistical data show that there are quite marked differences between individual countries in Europe. Some countries are experiencing rather high population growth due to immigration, while both the proportion of people aged 65 years or more and life expectancies are higher in Western than in Eastern Europe. But the basic pattern is the same: life expectancy has risen, while the retirement age has fallen. Old people are also getting healthier, so incentives should be created for them to stay in employment longer. Further improving health will be crucial for the future and examples from Hungary and Finland show what can be achieved through concerted campaigns. A special focus should be put on addressing the causes of cardio-vascular diseases, especially smoking. Challenger Jean-Michel Chatagny agreed with the main arguments presented by Hans H. P. Groth, but drew particular attention to practical questions of improving health levels: how to do so and how to finance it. The group agreed that prevention is of paramount importance, since the costs of prevention are significantly smaller than the costs of treatment. It was pointed out that, above all, prevention needs to be systematic, which is why company policies can make a valuable contribution. Hans H. P. Groth raised a second important point: just as people’s financial literacy must improve, so does their medical health literacy. However, this cannot be left to individuals but must be promoted through some sort of health education.

G. Demographic Change and Frameworks Impacting Intergenerational Solidarity in Pension Schemes

Introduction: Axel Hesse, SD-M Sustainable Development Management
Challenger and Moderator: Klaus Woltron, MINAS Beteiligungs- und Management GmbH

Axel Hesse presented his thoughts by way of four theses. First, pension funds can be regarded as the “ideal sustainable owners”, because their goals lead them to think in a cross-generational manner and because companies are interested in long-term investors. Second, there is large variety of sustainability criteria. It is helpful, therefore, to focus on a selection of them, for example the six most important sustainability challenges for the 21st century (the “big six”). If one does so, global population growth emerges as the main sustainability challenge associated with demographic change. Providing pensions in developing countries could actually reduce this growth, since increased financial security in old age directly influences fertility rates. Third, good corporate governance and sustainability management

have indeed become important considerations for pension funds in selecting investments. Fourth, sustainable development key performance indicators (SD KPIs) do have an impact on inter-generational solidarity in pension scheme investments. However, investors demand such SD KPIs to meet certain requirements: business relevance (with regard to both opportunities and risks), quantitative measurability and annual disclosure over time. Axel Hesse picked two examples, fleet consumption for the automobile industry and greenhouse gas intensity of energy production for utilities, to show that the use of SD KPIs does translate into better financial performance. But although usage has been increasing in many countries, focused approaches are not the rule yet. Whether stock selection according to sustainability criteria really results in financial outperformance was questioned by some in the working group, but at the same time there was general agreement that it does not lead to underperformance, either.

H. Pension Market Trends and Regulation in Eastern Europe and Asia

Introduction: Alexander Börsch, Allianz Global Investors
Challenger and Moderator: Alexander Barkawi, SAM Indexes

Most countries in Central and Eastern European (CEE) and in Asia face serious demographic challenges due to rising dependency ratios. In his introduction, Alexander Börsch first put the focus on CEE countries. Pension systems in the region have been reformed to varying degrees but have on the whole followed the World Bank model advocating three pillars. The first, public, pillar has been reformed everywhere to strike a better balance between contributions and benefits. The main difference to Western systems is the widespread introduction of a mandatory second pillar with individual accounts managed by private pension funds, as opposed to (mostly) voluntary occupational pensions. A further feature of CEE systems is that the majority of them have some limits on equity and/or foreign investment, with a view to promoting the development of local capital markets. In Asia pension systems are highly diverse, but nevertheless some common reform trends can be identified. These include new occupational DC schemes, improving coverage of the first pillar public pensions and increased outsourcing of public assets to private companies. China has closely stuck to World Bank recommendations and introduced a three-pillar system with funded second and third pillars, though coverage is only 42 per cent in urban areas and 10 per cent in rural areas. In the discussion one participant wanted to know how the impressive performance of EEC countries in reforming their systems had been possible. In his answer, Alexander Börsch pointed to the large pressure on the old systems and the strong influence of the World Bank during the economic transformation of the 1990s. With regard to the situation in Asia, attention was drawn to the huge challenges faced in countries with large informal sectors, caused by the breakdown of traditional family-based provision due to demographic change. Microfinance was forwarded as an additional asset class with sizeable development benefits.

I. The Impact of Inheritances on Financial Markets

Introduction: Reto Fehr, Credit Suisse
Challenger and Moderator: Thomas Streiff, The Sustainability Forum Zürich

Not only are people getting older today, thanks to modern retirement systems they are also getting wealthier, as Reto Fehr pointed out: no other age group has larger net assets available than people aged between 60 and 69. But instead of spending their money, older people tend to go on saving because of long life expectancy and fear of high medical costs. The overall result of these trends is that inheritances will increase significantly in the near future, while the average age of both testators and heirs will also rise. This has immediate implications for financial markets. Because older investors (55 years or more) in general have secure pensions and are familiar with equities and modern investment instruments, Reto Fehr expects that they will not invest more conservatively in the future. Furthermore, they have fewer consumption needs and are usually keen to preserve the inherited assets. At the same time, gifts can be expected to become more frequent with increasing life expectancy, particularly in connection with company successions. Given that about 50 per cent of all assets under management will be inherited over the next 15 years, large opportunities will arise for private banking. But the parallel challenge will be how to prevent outflows of funds. Credit Suisse has therefore been developing inheritance advice as a core competence in its on-shore business. This gives the company better opportunities to get to know its clients' prospective heirs at an early stage and ideally acquire mandates to execute wills. Specific services include advice on company successions and real estate and on making contributions to or setting up charitable foundations.

Frank Schirrmacher, Frankfurter Allgemeine Zeitung

"Seniorisation": Money Sink or Buried Treasure?

"What kind of people are these people we are dealing with in the next decades or in the year 2020 when the baby boomers will be 60 years and older? They are of course they same human beings but one central thing will have changed. This thing that will have changed is still in our heads and this is true for everybody in this room. If we had a time machine and we used this to go back to the place and the date of the birth of anybody in this room, there would always be one true assumption: all the societies that existed in the past, every single society, was structured in a way where the majority of people were young and the minority were old. It is very important to understand that this is an anthropological not only a historic assumption. Because many things that we take for granted, that we still have in our heads and in our systems stem from this, well, 'law' that people never really question at all.

No matter what we will or what we will not do, we will be the first generation in known history that will redefine ageing in itself because there is no other way. James Vaupel of the Max Planck Institute says very clearly: 'We need ten years back in society. We lose ten years because we have so few young children and we can only get these ten years back if we redefine the age and the timetable of a human being between 60 and 70 years.' This does not mean that everyone has to work until 70 but it is very likely that this will happen. But it will not happen as a law, it will happen because it is necessary for the individuals themselves. We know today that in Germany in 2011 or 2012 people who are older than 50 years will for the first time be a generation that has less money. After that the trend will increase very dramatically. The German state of Schleswig-Holstein just published figures for 2020: if nothing changes, 80 per cent of tax income will have to be spent on the pensions of civil servants alone. This is absolutely impossible and it is why the pressure will be so huge. You can actually see when this will happen: it will happen the moment the first major groups leave the workforce and retire. In Germany this will be between 2010 and 2012 and for the U.S. Alan Greenspan says it is 2006 or 2007, so apparently it is already starting.

The ageing workforce will redefine the way in which we look at ageing in itself, and we will have the help of the most fundamental science of our time, which deals with the whole question of what the human brain can do when it is older. As you know, this is something that strangely enough people do not accept in Europe, but in America they do and in Japan they do: today we know that it is wrong to say that with ageing the human brain comes to a stop and loses its capacity. In fact we know today that it is different – there was a Nobel Prize in 2000 for this insight – that if you train the brain, if you provoke it, if you use it, it is a kind of muscle and this muscle will be needed in our societies. The point is we do not only need the ten years in the workforce, we need them on the consumption side, too. We need people who are creative, who are optimistic and think: 'Well, I could still buy a car or I could still buy something bigger', which they would never buy if they still believed in the timetable of 1880 when a human life was over with 65 or 66 years."

Pfizer

Demographic Change: Challenges for the Pharmaceutical Industry

The age distribution of the Swiss population is changing at an unprecedented pace. Consequently, the number of people aged 65 years or more will rise from 1.3 million in 2010 to about 2.5 million in 2050, while the entire population will grow at an insignificant rate. At the same time, not only will the numbers of those in the age category 20 or less shrink, but also those aged between 20 and 50.

This emerging demographic reality is creating new business opportunities and models for the research-based pharmaceutical industry and its demographic "fitness" depends on the following three key factors:

1. Development and provision of a product portfolio that reflects altered illness patterns
2. Inclusion of preventive and health-preserving strategies to augment the benefits of pharmacotherapy
3. Promotion of health education and individual responsibility to optimise individual and public life-long health planning

The pharmaceutical industry needs to add value in these three areas in terms of innovation, networking and new partnerships. If it succeeds in carrying out these endeavours, it will continue – perhaps even more so – to make an indispensable contribution to extending people's lives in good health and with a high quality of living for as long as possible.

The latter point relates to one of Pfizer's long-term goals, which strives to facilitate people to age in better health and increase their future economic potential. This will allow countries affected by demographic change to turn a competitive disadvantage into an advantage. It is, nevertheless, primarily the task of politicians to change the corresponding framework conditions (e. g. mandatory retirement age), while the role of the research-based pharmaceutical industry will be to further develop curative, palliative, health-promoting and preventive approaches. The ultimate goal is to enable "demographic fitness" both of individual and public health.

Dr. med. Hans Groth

Member of the Executive Board, Pfizer Switzerland

Pfizer Switzerland
With sales of USD 50 billion (2006), Pfizer Inc. is the largest research-based, stock exchange listed pharmaceutical company in the world. The corporation is represented in more than 150 countries and has in excess of 100,000 employees.

Pfizer Switzerland has 220 employees and markets more than 100 drugs, of which the key therapeutic areas are cardiovascular diseases, diabetes, pulmonary disease, pain, urology, eye diseases, nervous disorders, infectious diseases (incl. HIV) and oncology. Furthermore, it offers a wide range of medicines for farm and domestic animals.

Working together for a healthier world

Conclusions

Looking back at the 8th International Sustainability Leadership Symposium, there was something striking about the overall mood of its keynotes, panels and workshop discussions. Though coming from different professional backgrounds, the assembled speakers clearly had a strong consensus on the facts and challenges of demographic change. Yet at the same time they seemed to share a certain sense of alarm at the slow responses observed so far. This contrast between what is known and what is (not) being done pervaded the symposium's discussions and stimulated the participants to put a strong focus on practical recommendations.

Part of the explanation for the hesitant reactions probably lies in the fact that the phenomenon of ageing societies is in the process of creating an entirely novel situation, as a number of speakers emphasised. Never before in known history has there been a society with more old than young people. Demographic change thus has an important anthropological dimension since many of the basic assumptions we make about life are rooted in earlier periods with traditional age compositions. These assumptions will have to be rethought much faster than people seem to realise.

In financial terms, the key challenge posed by ageing societies is the increasing pressure on our current systems of old-age provision. In view of the massive shift expected in dependency ratios between those who pay contributions to retirement systems and those who receive them, the whole concept of solidarity between generations will have to be reinvented though not abandoned, as one keynote speaker put it succinctly. While traditional defined benefit schemes can retain a role in the overall systems, the majority view was that large parts will need to switch to defined contribution schemes. In parallel with this, individuals should be given greater responsibility and more choice for their retirement provision arrangements.

These structural changes will require the availability of suitable financial products. At the symposium a lot of attention was focused on annuities. Since they were identified as a key product for the future, some surprise was expressed at their relative underdevelopment so far. The reasons for this seem to be twofold: first, annuities are sophisticated products that react sensitively to small deviations from predicted longevity trends, which makes them difficult to manage. Second, in some countries at least their development seems to be slowed down by a lack of awareness among policy makers, for example on the need for accurate mortality tables and supportive tax conditions.

In view of the growing need for individuals to fund their own pensions, there was a strong call for making better use of asset management to maximise long-term returns. In this respect, criticism was levelled at regulators for presumably favouring a traditional security-based insurance approach in the pensions market, thus denying other financial services players equal access and consumers the possibility to choose their individual risk-return profiles.

The impact of regulation in general emerged as one of the symposium's key topics. With regard to the situation in Switzerland, the audience was reminded that pension regulation involves several bodies whose policies are not always very well coordinated. Regulators were therefore urged to harmonise policies and to eliminate differences that tend to hamper the development of new products and create perverse incentives. As one keynote speaker argued, regulation for insurers and pension funds should in principle be the same unless there are concrete arguments justifying differences. Preference for this approach was echoed on a supranational level.

In connection with the call for reforming pension schemes, one issue was raised time and again during the symposium: the need to improve financial education. If people are to assume more responsibility for their retirement provisions and understand why this is required in the first place, they need to have a solid grasp of finance. At present, this knowledge was said to be "astonishingly low". Furthermore, people must be supported through better consumer protection and more transparent and understandable guidance on products. In this context, the industry was urged to do its homework and take a more customer-friendly approach.

But if the challenges of reforming pension systems may seem a little daunting, at least the much talked about asset meltdown hypothesis was flatly rejected by several speakers. First, the saving behaviour of older people seems to deviate from the large-scale dissaving predicted by life-cycle theory. Second, and more to the point, it was emphasised that there is no established economic theory in which long-term interest rates and asset prices are determined by savings in the household sector alone. Other factors such as technological progress and investments need to be taken into account as well, which makes the causality much more complex.

Changing the financing mechanism of pension systems would instil more individual responsibility, take pressure off younger generations and, if handled properly, improve long-term returns, but this alone will not be sufficient to secure adequate funding. For many speakers it was clear that people would have to work longer again. In this respect, some interesting cultural differences were pointed out. In Japan older people seem to remain highly motivated to go on working. There are institutional obstacles that prevent tapping this potential, though, in particular the seniority-based wage system and mandatory retirement in private companies. These problems need to be addressed, alongside training programmes to eliminate skills mismatches.

In many European countries, in contrast, retirement by the age of 55 has become standard practice. A number of policies – pension laws but also labour regulations, educational approaches and healthcare policies – actively discourage people from working longer. At the root of this there may be a mentality problem: in Europe there seems to be less trust than elsewhere in people's ability to go on working in today's competitive labour market after they have reached a certain age. In the face of looming recruitment difficulties, employers were urged to change their attitudes and reshape their policies towards older employees.

The massive exit of people in their fifties from the labour market is all the more remarkable because on the whole they enjoy much better health than earlier generations did. Maintaining, and even improving, health levels was identified as a further important measure on the labour supply side. The key to this is prevention, especially of cardio-vascular diseases, because it is much less costly than treatment. Company policies were said to play an important role in promoting prevention, but at the same time the idea of comprehensive health education was proposed as a means to help individuals improve their "medical health literacy".

Recent research in brain science has also shown that the human brain operates like a muscle that can retain its capacity for a long time if it is regularly used and stimulated. Given these opportunities for extended health and fitness, society simply has to redefine the way it looks at ageing. This is not only true for the role that people can play on the supply side of the economy but also for their behaviour as consumers.

Many of the measures and remedies proposed during the symposium require changes in, and harmonisation of, the regulatory framework, and so are ultimately the responsibility of politicians. Considerable scepticism was expressed concerning their willingness to actually embrace these changes, though, because many of them would by definition be unpopular. Financial education was again put forward as a solution: education of the politicians themselves and education of the population, because a better understanding of the issues by the electorate would increase the pressure on politicians to take action.

The second recommendation involves the financial industry itself. Given their extensive know-how of the principal trends and challenges, providers of insurance and pension fund products were urged to take a more active role and seek an ongoing dialogue with governments and the general public, with a view to advancing workable solutions. The Sustainability Forum Zürich hopes it may have made a contribution to sharpening awareness of this.

The Sustainability Forum Zürich

The Sustainability Forum Zürich (TSF) is an independent, non-profit, non-partisan association, founded by leading representatives from business, science and public authorities from Zürich and increasingly joined by financial market players from throughout Europe. It has the purpose of organising and realising the annual International Sustainability Leadership Symposium and other dialogue events as well as connected research and promotion of projects, in particular as pertaining to the sustainability topic relevant to the financial market.

Rapid globalisation produces great economic and public upheaval; it essentially changes the playing field and in some measure the rules of the game for business pursuits. On the one hand, the private sector benefits from a significant expansion of its entrepreneurial scope. On the other hand, new challenges emerge: e.g. demographic change, increasing international mobility, shortage of resources, climate change and pandemics. For business, globalisation therefore means greater opportunities as well as risks, greater freedom as well as extended responsibility.

Because of their service and hinge function between the “real economy”, the capital market and society, the players in the financial market – independent of their size and their sphere of influence – deal with these challenges early on. Only in this manner can they maintain their competitive capacity and thereby ensure their existence in the medium to long term.

The following questions are thus posed:

- What are the sustainability issues and related challenges the financial market players will be exposed to in future?
- How does the financial market react to the expected new framework conditions and incentives in order to remain competitive, i.e. to be able to utilise the evolving “sustainability opportunities” and to avoid and manage risks.
- How is entrepreneurial and societal responsibility changing and evolving, in the financial industry in particular and in the private sector in general – and how will the inter-linkages work and where are its limits?

Living up to a transdisciplinary approach is a crucial principle which will be achieved by building up and maintaining strong relations with science and other competent and credible sustainability organisations.

Objectives

TSF provides its members and partners with a dialogue platform that enables the exchange of the most cutting-edge knowledge, experiences and opinions on challenges relevant to the financial market. Companies, experts and scientists, other financial market players, asset owners and capital market regulators are invited to

- "Get fit": Getting the main players fit through early recognition of financial market relevant, social and geopolitical issues and trends;
- "Challenge mind-sets" of the decision makers in financial sector with respect to their social responsibility, the resulting challenges and of the financial market players with respect to their innovation and communication capacity;
- "Promote options for actions" of the financial market players. The ambition is to improve the efficiency and effectiveness of market practices and instruments and to simultaneously create societal added-value.

TSF's Symposia to Date:

2000: Sustainability – Driver to Economic Success?

2001: Financial Services – Drivers to Sustainability?

2002: Governance for Sustainability: Making Corporate Responsibility Work

2003: Towards a More Sustainable Retirement System: The Quest for New Governance and Asset Management Strategies for Pension Funds

2004: Business Investment in Development: Experiences and Perspectives

2005: The Market Value of Reputation

2006: From Short- to Long-Term: Who Cares? Institutional Investors, Beneficiaries and Investees in Dialogue

Vision

TSF seeks to contribute to sustainable business in the dynamics of globalisation by promoting forecast, reflection and action in and through financial markets and its key players.

Mission

TSF aims to take up topics relevant to the future, by way of an action-oriented dialogue with internationally recognised topic leaders and decision makers, enabling the integration of entrepreneurially relevant sustainability principles in the financial market.

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