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OPINION

The pursuit of effective pension solutions

Addressing structural challenges by embracing emerging opportunities

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“Pension underfunding is the climate-change moment of social systems” – the line that struck a chord at media outlets across the globe in May, when Michael Drexler said it accompanying the release of the World Economic Forum’s white paper on retirement investment systems. A “global pension time bomb with a funding gap set to dwarf the world GDP” read the news release headline.

As head of financial and infrastructure systems at the WEF, Mr. Drexler, unfortunately, is neither wrong nor exaggerating. It will be very hard, even for seasoned pension sector insiders, to properly address such a massive challenge. That’s especially so since effective solutions might structurally change the fundamental landscape of the industry.

The reality is that borders between industries, products and geographies are fading away. To capitalize on emerging possibilities, one should transcend existing silos and traditional concepts or definitions. Consumer behaviors are changing, as are social contracts and employment and retirement patterns. With that perspective in mind, allow us to assess the changing landscape, look far ahead at a future that might seem generations away, and bear with us as we zoom back in on the currently thriving niches and socio-behavioral changes happening now that will transform the retirement investment industry.

Innovation agendas

From a global perspective, we see a gradual move toward pension schemes focused on individuals’ contributions rather than shared group benefits. In many Western countries, the innovation efforts of traditional pension funds are focused on the effective allocation of assets and the consequences of aging societies. A good number of funds are also finding technologically efficient ways to engage plan participants, while operational cost-cutting is a parallel theme. Relatively newer entrants in Europe and the United States build on efficient IT and liberalized markets to offer fairly traditional products or more innovative robo-advisory wealth management services. Overall, such players continue to operate from a structure quite similar to that of a traditional pension fund. For more radical innovation in financial services, one must look East.

It is no accident that China is home to four of the world’s five top fintech companies, according to a Feb. 25 article in The Economist. Those companies, Baidu, Ant Financial, Tencent and JD.com, are not pension funds. But with more than 400 million citizens using their phones as wallets, per The Economist, and almost half of all digital payment transactions conducted in China last year, a prime example is set on how new technology can leapfrog traditional infrastructure.

Citizens worldwide are trying new things, too. Their perception of the concept of work, particularly their attitudes toward self-employment and gig economy work, is evolving fast. McKinsey estimates roughly 72 million people in the U.S. and Europe earn their primary income as independent workers, while a further 90 million people work independently on the side. Consumers are also rethinking ownership. Whether it be renting out a room through Airbnb or joining a car sharing scheme, attitudes are changing. Digital connectedness unleashes powerful networking effects on these trends.

Pioneering leaders

While having sufficient resources for old age is a key element to citizens’ well-being, pensions are only a part of the picture. In April 2017, World Bank president Jim Yong Kim noted that two-thirds of all jobs in developing nations are threatened by accelerating progress in automation and robotization. Yet financial inclusion is an integral part of social stability. And it is under increasing pressure worldwide.

When many people would not or could not depend on steady and sufficient income streams from traditional work, the most ideal outcome might then be that each person, individually, were a fractional owner of every service and product she or he might use.

While widely dispersed ownership in proportion to individual needs might sound far-fetched, the current state of blockchain and cryptocurrency already enables anyone to hold fractional, decentralized and fluid assets that are digital and highly usable. Slowly but surely, legislation also is changing to accommodate such a new era. In fact, the groundwork of a whole new ecosystem in digital asset management is quietly being installed. Crossover products based on blockchain technology will find their way into the mainstream. The inherently inclusive nature of its architecture can shift a significant part of the (impact) investment movement from being activists for innovations toward actually becoming the driving solutions themselves. Using a needs-oriented mindset, vs. a wealth-focused investment approach, can position future-thinking financiers at the forefront here.

Today's leading pension funds should partake, even if the financial returns or business alignments are not yet fully clear. Alignment with a new ecosystem will help make a more gradual transition into the future and may even result in new services for current customers. Technology that can cost-effectively focus more on specific characteristics of the individual also has the benefit of allowing mass customization in multiple dimensions. Planning for one lifetime instead of generations requires a redesign regarding longevity and (insufficient) income growth. Perhaps a new perception of securing financial continuity and sharing wealth is therefore in order. A transformation of the traditional savings models as the core pension product, toward a design that concurrently blends accumulation with decumulation, or use, would have significant potential to address part of today's challenges. Here, again the fractional and fluid nature of digital assets helps greatly.

Conclusion

Established players should not take it for granted that people will keep on participating in traditional ways by default. Our society has always gradually evolved, from ancient Greece and Europe in the 17th century onwards. Attitudes change, new, technology-enabled possibilities open up and the flow of money alters as a result. A data-driven civilization might very well mark the commencement of an era with new economic values. Just as use of assets has become more fluid, so will ownership of assets. The way we describe pensions will fade away. Today, having the luxury of a proper pension arrangement could certainly be considered an asset. It makes sense to wonder how parts of such an arrangement could become fluid in the future. Digital assets will enable this. Their value as an investment asset class will rise exponentially.

From a societal perspective, decentralized and fractional access could be very beneficial. Properly organized, it could increase economic inclusion and social stability. These are two core pillars at the heart of traditional institutional investors like pension funds and insurance companies. As not all people will be capable or interested enough to navigate such new landscapes, well-known brands and trusted organizations could play an important role in that journey. Companies must position themselves in this new environment today, or risk irrelevance in the future. Whatever the specific products and services of blockchain and cryptocurrency may be: when financial transactions are a backbone to your organization, a new ecosystem operating outside of yours warrants your attention. Forming strategic partnerships and prudently joining radical experiments shield investors from inertia and allow them to learn from a potential "known unknown" factor affecting the future of the industry. Not only are negative correlation benefits to portfolio risk management available, you also have a unique opportunity in leading society toward greater economic inclusion.

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This article is an abbreviated version of "Pursuing Potential in Evolutionary Pension Structures." A full version of the authors' paper can be downloaded at www.investmenttransformation.com. In full disclosure, the authors have stakes in new digital infrastructure products as founders and investors.