

## An Investment Strategy for Rural Pensions

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Assumption 1: What sort of pension is a rural pension?

- Will it provide basic minimum income or supplement basic minimum income?
- Rural pensions are and are likely to be a DC scheme
- Payout based on
  - Level of contribution,
  - Gross return and
  - Level of costs during accumulation and payout phase
- Risk lies with individual contributor as to the level of payout

Assumption 2 : What are we trying to provide?



- A 'decent' lump sum and / or
- An annuity (regular income during retirement to replace reduced or no income from farming) and/or
- A fund to meet exceptional costs and/or
  - (particularly out of pocket health costs)
- A fund to transfer to / buy-in to the urban schem

Assumption 3: When are we trying to provide it?



- At a fixed retirement age ( 60 or 65)
- At an age to be determined by the farmer but beyond a minimum age limit
- When he / she needs it (in the case of health or education costs)

Assumption 4: Who are we aiming it at?



- All farmers (no matter what level of income))
- Farmers with lump sum compensation for lost land
- Well-off farmers (potential regular savers)
- Under a certain age limit (eg below 40 who can be expected to contribute for at least 20 plus years)

Key Consideration 1 : Level of Contribution



- Irregular saving and/or
- Relatively small regular contributions
- Lump-sums
- Relatively few assets and no real safety net



Likely to be risk adverse

### Key Consideration 2: Disbursement (Pay-out)



- **Uncertain Life Expectancy**
  - Life expectancy at retirement / for male & female
  - Moral Hazard of underestimating life expectancy
- **Very immature – untested – annuity market**
- **Need for fast access to sums in health emergencies**

### Key Consideration 3: Factors Affecting Return



- **Potential high administrative costs**
  - Research in Europe shows private schemes at least 5 times more expensive than mandatory occupational schemes
- **Size of pooled funds**
  - Economies of scale
  - Bearing of Risk
- **Costs of ‘active’ versus ‘passive’ investment strategy**

#### Assumption 4: Very Difficult Investment Climate



- Real interest rates negative
- Extremely high volume of deposits
- Immature equity market with extensive volatility and poor Corporate Governance
- RMB likely to appreciate in short to medium term
  - Currency risk for foreign investment
- Very limited other channels
  - No index linked bonds/ few corporate bonds

#### What this means 1 : For Scheme Design



- Supplementary income scheme
- Aimed at better off and /or with lump sums
- Aimed at those under 45 (Minimum 15 year contribution)
- Flexible in terms of paying partial lump sum to meet emergencies
  - E.g Kiwi Saver Scheme (NZ) CPF (Singapore)
- Lump sum plus restricted annual payout – no annuity
- Transferable buying added years in urban scheme

What it means: For Scheme Design and Administration



- No Government run funds but Government supervision
- Limited number of Pooled mutual funds
- Limited number of approved suppliers
  - Banks / Financial Institutions with extensive network (e.g Agriculture Bank / China Post) working with investment partners
- Cap on management charges
- Competition based on returns generated in medium and long term

What it means for: Investment Strategy 1 (Objectives)



- Optimise net return with 'acceptable' risk
  - Beat current deposit rates
  - Beat inflation
  - Generate decent lump sum capital embedding consistent real growth of 1.5 to 2.5 % per annum
  - Allow for fast un-complicated partial withdrawal

What it means for Investment Strategy 2 (Allocation)



- **Balanced Portfolio**
  - (Equities / Fixed Income / Money Market / Alternatives –e.g Commodities/ alternative financial instruments)
- Significant weighting for equities for growth
- Significant weighting for fixed income for relatively risk free return
- Money Market for liquidity

What it means for : Investment 3 (Allocation)



- **Suggest 3 basic portfolios**
- 1. 'Adventurous'
  - (Equities 35-45%, Alternatives up to 10%, Fixed Income 30 – 45%, Cash 10%)
- 2. 'Medium Risk'
  - (Equities 25-35%, Alternatives max 5%, Fixed Income 40-50%, Cash 10-20%)
- 3. 'Secure'
  - (Equities 15 – 25%, Fixed Income 50% - 65%, Cash 10% - 35%)
- Lifestyle default moving from adventurous to secure as you close on retirement

What it means: For Investment 4 (Active or Passive Strategy)



- Active Investment costs money – higher volume of transactions plus higher fees
- No evidence in long term of higher rates (although skilful active investment may help smooth 'return')
- Passive therefore recommended:
  - Use Exchange Traded Pooled Funds to track key indices with unit fee paid as 'basis' points of benchmark return (0.15% - 0.65%)

What it means: For Investment 5 (Government Action)



- Develop Government Bond Market further
  - Index-linked bonds available to privileged investors
- Stimulate further development of Company Bond Market
- Tax Exempt dividends paid into rural pension mutual funds & look at feasibility of exempting transactions from stamp duty