Norman Chan: Self-made life pension

Remarks by Mr Norman T L Chan, Chief Executive of the Hong Kong Monetary Authority, at the Philanthropy for Better Cities Forum, Hong Kong, 20 September 2018.

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Distinguished guests, ladies and gentlemen

1. One of the biggest challenges in many societies in recent decades is how to ensure that the elderly have sufficient income or financial means to maintain a decent retirement life. Many governments have introduced different forms of pay-as-you-go retirement support schemes, which unfortunately have now proved to be hard to sustain fiscally in the longer run if the population is ageing rapidly.
2. The Hong Kong population is also ageing. While we celebrate having the longest life expectancy in the world, with women reaching 87 and men 81, this also creates tremendous challenges for retirement protection. In the context of retirement protection, I can divide the population into three groups:

   (i) high income people who have accumulated significant amount of savings and wealth during their working life. They have the financial means to take good care of themselves during retirement and we need not worry about them;

   (ii) the underprivileged, working poor or lifelong poor. This group of people depends crucially on the social safety net provided by the Government as they don't have the ability or financial means to look after themselves. In Hong Kong, the Government support mainly takes the form of Comprehensive Social Security Assistance, highly subsidized housing, health care and education. As for the elderly, the Government provides a non-contributory means tested Old Age Living Allowance for those aged 65 or above; and

   (iii) people that do not fall within either of the first two groups. Typically this group of citizens are those who have worked hard for their whole life, used up the bulk of their earnings in raising their children, and may be owning a small apartment. Most of them, by the time they retire, do not enjoy any pension or other forms of voluntary retirement benefits. They do have some accumulated savings in their Mandatory Provident Fund accounts, but it is unlikely that, for various reasons, the amount, on its own, would be large enough to support a decent retirement life.

3. It is the retirement protection of this third group of citizens that I wish to address today. In Hong Kong, about 70% of the 1.7 million privately owned residential housing units, including subsidized home ownership flats, are owner-occupied. Around 65% of the owner-occupiers have fully paid down the mortgage loans, if any, of their properties. For those owner occupiers who have already paid off their mortgages, many of them don't have a lot of other savings or assets at their disposal. Even for those with some savings, they are having a tough time in managing their money if they don't have the expertise or the appetite in active investment. This is understandable because, under the prolonged period of quantitative easing by the major central banks in the advanced economies, bank deposits and bonds offer rather low and unattractive interest income. As for the stock market, the volatility in share prices will expose the retirees to significant market risks. As a result, there can be a fairly large group of retirees who find them not having enough cash flows to support a decent retirement life, despite the fact that the properties they own and occupy are worth quite a lot.

At the same time, their cash savings are basically left idle, yielding very little, if any, cash flow income. Many old folks would feel apprehensive to dip into the principals of their bank savings to meet daily expenses, as this would expose them to the uncertain but rather scary longevity risk. This situation is not unique in Hong Kong as there are many places that have similar problems. So it may be useful if I share with you the Hong Kong experiment in helping this group of retirees through some market based and financially sustainable solutions.

HKMC and Market-based Financial Solutions for Retirees

4. These market based retirement protection solutions are developed and operated by the Hong Kong Mortgage Corporation (HKMC), which was set up in 1997 and is fully owned by the Government through the Exchange Fund managed by the Hong Kong Monetary Authority (HKMA). The HKMC runs on commercial principles and its main role is to offer financial products that would facilitate market development as well as achieve desirable social objectives. The core products offered by the HKMC include the purchase of mortgage loans from banks for securitization, the Mortgage Insurance Programme to help eligible homebuyers with their down payments, and the SME Financing Guarantee Scheme that supports SME financing by banks. In addition, two HKMC products, the first one launched in 2011 and the second one a few months ago, are of particular relevance to the financial wellbeing of the retirees.

Reverse Mortgage

5. The first retirement protection product is the Reverse Mortgage Programme, which enables homeowners to convert or monetize the equity in their self-occupied homes into guaranteed monthly payouts over 10, 15, 20 years or for life, while still enjoying the use of the properties. For example, a married couple at the age of 65 with a property value of $5 million would get a guaranteed payment of $11,000 per month for life and be able to live in the property for life. There is no need for them to worry about repayment at all. Their monthly payouts are guaranteed for life even if the value of the property falls in subsequent years, or the interest rates rise significantly, or the couple enjoys very long life. When the couple passes away, and if their children choose not to redeem the property, the bank will recover the outstanding loan with accrued interests by selling the property in the open market. Any surplus will be returned to the children of the borrowers or their designated estate. If there is any shortfall, the HKMC will take care of the difference because the borrowers, when taking out the Reverse Mortgage, have already bought insurance from the HKMC to cover the shortfall risk. This scheme would not have been commercially viable for the banks without the insurance provided by the HKMC to cover the potential shortfall risk due to either falling property prices, rising interest rates or increasing longevity of the borrowers. So far, over 2,500 households have joined the Reverse Mortgage Programme. The initial take-up rate was not fast but is picking up steadily. It has taken some time for Hong Kong people to get to understand and appreciate this new product. Also, it is quite common amongst Chinese parents wishing to pass their properties to their children without encumbrances, which will not be the case if they have joined the Reverse Mortgage Programme. However, there is increasing awareness amongst retirees that they do need to take care of themselves rather than suffering from a steady drop in living standards due to insufficient recurrent cash flows.

Life Annuity Scheme

6. The second retirement protection product, which has just been launched by the HKMC through its subsidiary, is the Life Annuity Scheme (LAS). The Scheme aims to provide a financial solution to retirees who prefer to convert their lump sum savings into a steady stream of cash flows that are not affected by the fluctuations of the financial markets or how long they live. In other words, they prefer something like the old fashioned pension through which the employees would receive guaranteed monthly payments for life. As we know, people now live longer due to improvement in healthcare, diet and exercise etc. At the same time, most if not all employers have withdrawn from offering life-long pension benefits because of the huge costs involved. Moreover, the current low yield environment coupled with high volatility of the financial markets have also made it hard for any defined contribution pension plans to guarantee anything other than a rather low rate of return.
7. What the HKMC is doing is to offer a life annuity product to those aged 65 and above. The HKMC will guarantee an immediate fixed amount of monthly payout for each annuity policyholder. For a person at 65, with a HK$1 million premium, the monthly payment guaranteed for life is HK$5,800 for male and HK$5,300 for female, equivalent to an annuity rate of about 7% for men and 6.4% for women. The reason that the HKMC can offer rather high annuity rates is because it will place the entire annuity premium received from policyholders with the HKMA. The HKMA will then invest the money alongside with the Exchange Fund portfolios, half in the public markets (bonds and listed equities) and half in private markets (private equity and real estate). As the HKMA already has the investment capability and infrastructure for managing a portfolio as large as around HK$4 trillion, it would be easy to take on the additional investment generated by the HKMC's annuity premium. The HKMC has now received around 10,000 applications amounting to $5 billion in subscription. We are processing the applications and the exercise is expected to be completed soon. By end-October or early November this year, the first annuitants will be receiving their first monthly annuity payments.
8. Let me do some quick maths here by using a married couple at the age of 65 who has joined both the Reverse Mortgage Programme and the Life Annuity Scheme. If the property they own is worth HK$5 million, (which is the average value of the properties under the Programme), then they would get a monthly payment of $11,000 plus the right of lifelong occupancy under the Reverse Mortgage Programme. If they each subscribe for HK$1 million Life Annuity, then they will get another HK$11,100 ($5,800 + $5,300) per month. So they will receive HK$22,100 per month. When the couple reaches the age of 70, they are entitled to a non-means tested Old Age Allowance of $2,690 ($1,345 x 2) provided by the Government. So this couple will be receiving up to HK$24,800 (or US$3,180) per month or around HK$300,000 (or US$38,000) per year, and have the benefit of being able to stay in their own property, for life. Compared with the median income of two-person households in Hong Kong of HK$20,000 (or US$2,560) per month,[1] this guaranteed monthly payout of HK$24,800 would really help support a decent retirement life and protect the retirees from highly volatile market risks and from increasingly high longevity risk.

Conclusion

9. I would like to conclude by making the following observations:

(a) The Reverse Mortgage Programme and the Life Annuity Scheme, when combined, will create an economic outcome similar to a life pension. This self-made pension is a market based solution to provide steady cash flows for life by liquefying the fixed and financial assets accumulated by the retirees during their working life. The schemes are commercially and financially viable and will therefore not involve Government subsidies;

(b) The launch of the Life Annuity Scheme has helped promote the annuity market in Hong Kong, which has up till now been rather underdeveloped. In 2016, the annuity business only accounted for less than 2% of all long-term insurance business of private insurers in Hong Kong. However, once we announced the launch of the HKMC Life Annuity Scheme in 2017, there has been marked increase in the awareness and interest in annuity products. Many insurance companies have seen sharp increase in the volume of business in underwriting other forms of annuity products to customers;

(c) The HKMC solutions, when implemented more fully, will not only help those who have retired but also provide a strong incentive for the middle income citizens to save. With the Life Annuity Scheme, they can see the prospects that their hard earned savings accumulated over their working life could be entrusted to a reliable manager to produce reasonable, hassle-free and guaranteed cash flows that support their retirement. This is particularly helpful to those who feel that the small amounts that they save today would not add up to support their retirement, hence find it tempting to spend more now and save less, relying instead on the social security net provided by the government when they retire.

10. Ladies and gentlemen, it may be a bit too early to assess the success or otherwise of the Hong Kong experiment. However, I am very excited by the prospects of the two HKMC schemes in helping retirees in Hong Kong to create self-made life pension. The model that we are pursuing in Hong Kong is not only highly innovative, it also serves as a pilot that, if proved to be successful, would provide a good model for many countries in the world as an additional retirement support option that is financially viable and thus sustainable over the long run.

11. Thank you very much.

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[1] Figure for the first quarter of 2018. *Source: Quarterly Report on General Household Survey (Q1 2018), Census and Statistics Department*.