SHIFTING DEMOGRAPHICS EXPOSES THE GAP FOR INCOME PRODUCTS

South Korea, Taiwan, Hong Kong and Singapore are projected to have the largest share of elderly population by 2050, with more than 4 in 10 persons aged 60 and above. The need for adequate and diversified sources of retirement income creates opportunities for financial service providers.

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Climate change, ageing population, urban explosion and the rise of technology are some of the most debated issues around the globe. Not surprising since the consequences of being ill prepared for these changes will likely be painful. At present, these structural trends include some of the world's biggest challenges and opportunities.

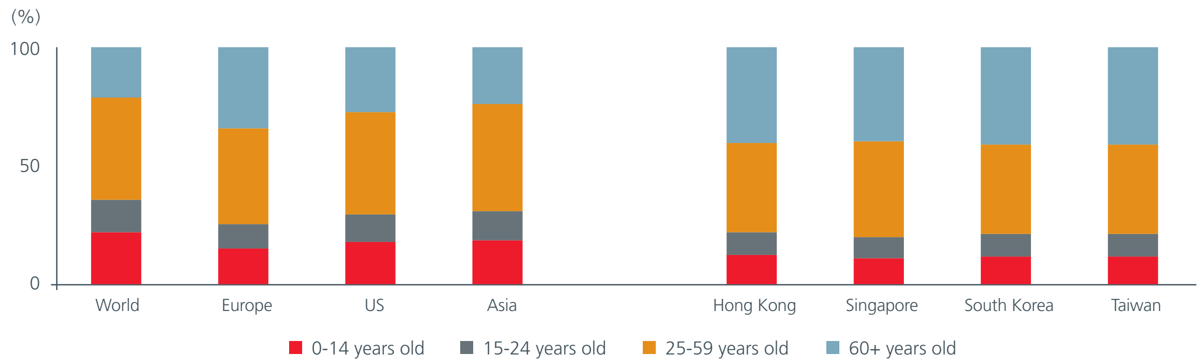
Climate change, for example, has paved the way for new investments in renewables in spite of the cost barriers while the rise of technology portends new jobs provided the requisite worker re-skilling is in place. Likewise, the challenges posed by an ageing population are wide-ranging. In particular, anticipating the future income needs of an ageing population is difficult. Accordingly, it has exposed the need for individuals to possess adequate and diversified sources of retirement income - therein lies the opportunity for financial service providers.

RETIREMENT INCOME PERSPECTIVES

One major source of retirement income in the past has been the national pension schemes. But increasing life expectancies and lower birth rates are placing a great strain on many such systems across the globe. By 2050 those aged 60 years and above will make up 21% of the world's population up from 2015's 12%. These numbers are far worse on a deeper dive with Europe's at 35% while Asia and US reach 24% and 28% respectively (see Fig.1). Individual country statistics are alarming in some cases.

Demographics aside, modernisation has led to changing expectations for each generation. Today's working adults are far more affluent and educated and expect to maintain their standard of living in retirement compared to the current group of

Fig.1: Shape of demography to come in 2050[1]



retirees. They are also more likely to be responsible for their own retirement income rather than turn to government or extended family support. The question is whether they are putting aside enough to support their future lifestyle.

Pension systems alone will not be sufficient; there is a growing gap between what is required during retirement and what is available, even among countries with developed pension systems. In fact, by 2050 the world's pension gap is projected at USD400 trillion[2]. Future retirees will have to look to alternative sources of retirement income.

ASIAN TIGERS NO MORE?

Within Asia ex Japan, South Korea, Taiwan, Hong Kong and Singapore also known as the Four Asian Tigers are projected to have the largest share of elderly population by 2050, with more than 4 in 10 persons aged 60 and above.

Changing attitudes and expectations are also evident in these markets. The role of the extended family in providing retirement security has given way to individual responsibility. Around 40% to 60% of the respondents across the adult age groups in these countries expect to be self funding in retirement (see Fig.2).

Given this preference for self-reliance, this same set of respondents expects to receive income from financial assets when retired. This can take the form of bank deposits, insurance or annuity policies and stocks or bonds.

Fig.2: Who should bear responsibility for providing income to retirees?[3]

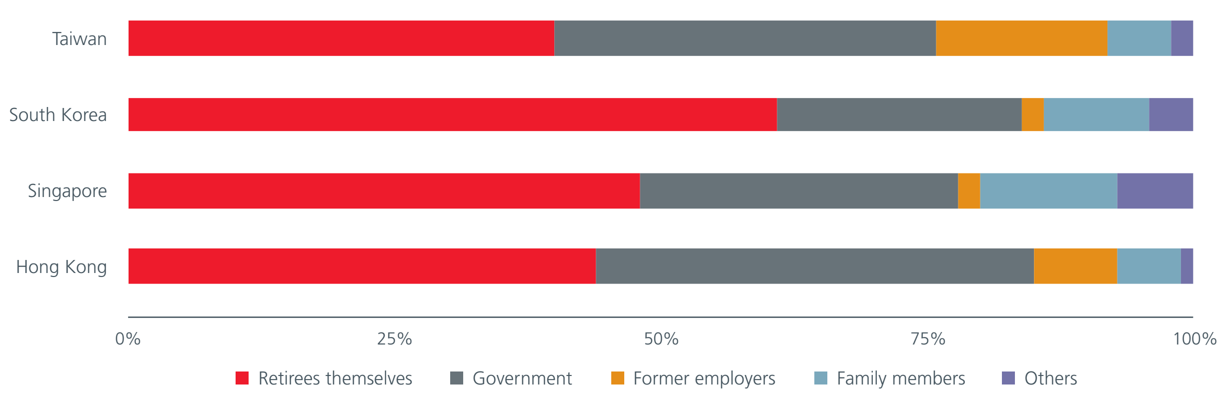


Fig.3: Respondents who receive or expect to receive some income from financial assets when they retire[4]

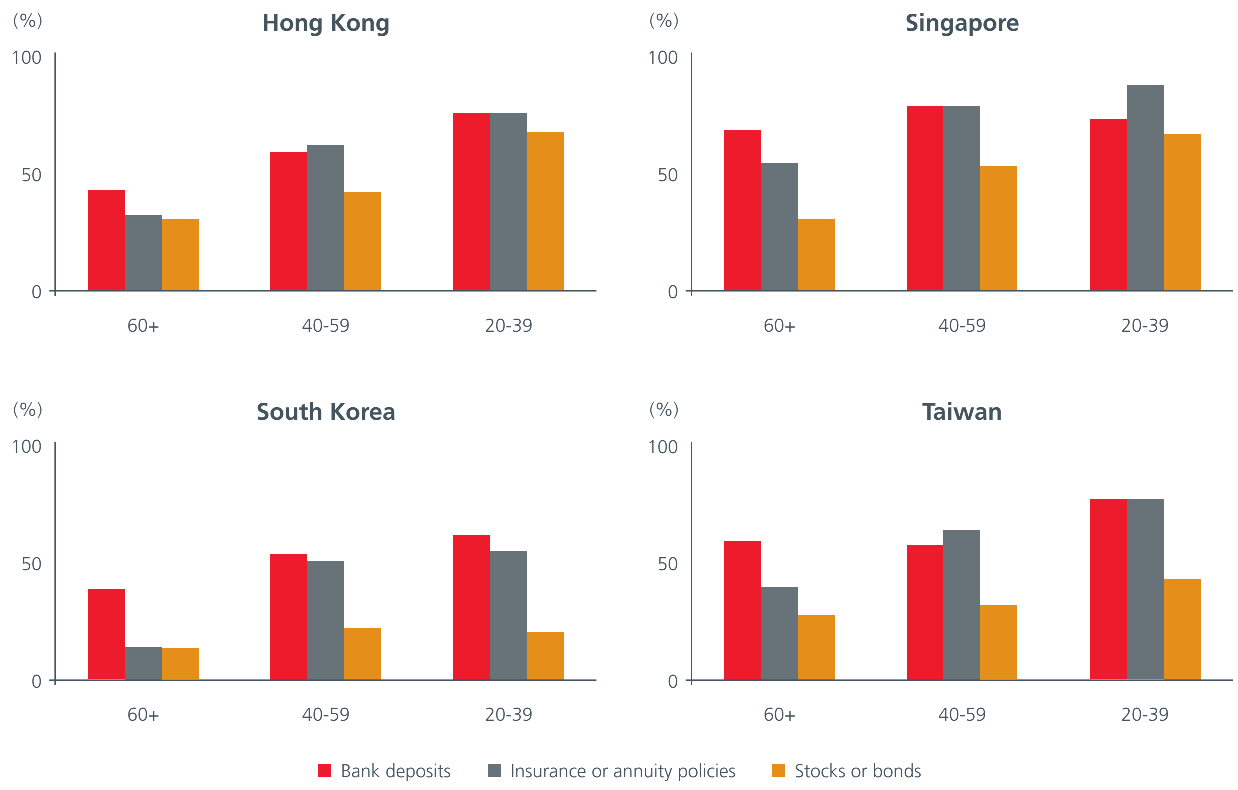


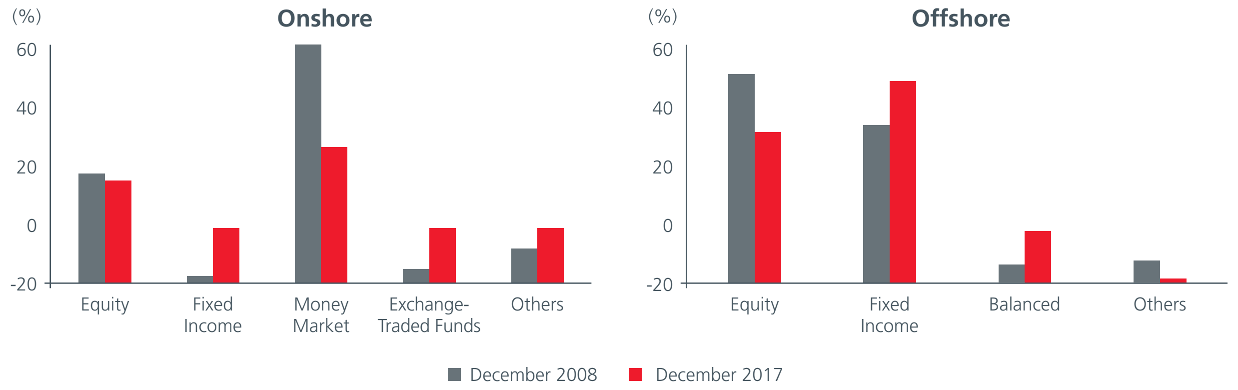
Fig.3 shows the current share of income from financial assets for retirees versus the expectations of workers aged 20-59. Across the board, the workers expect to receive more money from the financial assets compared to the retirees. But even more interesting is the significant increase in share of respondents expecting to receive income from stocks or bonds; in Hong Kong and Singapore the expected receipt rate among workers aged 20-39 rises to 66% and 65% respectively from 30% rate clocked by retirees. Similarly, in South Korea, Singapore and Taiwan there is a dramatic increase in share of respondents (aged 20-39) expecting to receive income from insurance or annuity policies.

Given the survey findings, it is no surprise that income-based investment products have been gaining popularity across the globe. Equally the quest for yield has been underpinned by the low interest rate environment over the past few years. This search for income is likely to remain even when rates nudge upwards, highlighting the huge potential for financial service providers.

IT IS ALL ABOUT INCOME IN TAIWAN

In Taiwan, the survey findings show a huge preference for the aged 20-39 to receive payouts by insurance or annuity plans when they retire. This generally ties in with the rationale that as the population ages, investor demand will likely shift away from risky assets and move towards the instruments with stable returns and low volatility. In Taiwan, the evidence is clear; fixed income investments have been beneficiaries. Onshore and offshore fund data show the growing preference of investors towards fixed income products. Over

Fig.4: AUM % by fund type in Taiwan[5]



the period shown in Fig.4, fixed income funds' share of AUM has grown from a mere 1% to 13% for onshore and 39% to 50% for offshore.

High yield bond funds, in particular, have been much sought after; retail investors in Taiwan have poured billions of dollars into high yield bond funds that offer attractive monthly distributions. Investment in high yield bond funds peaked in 2014, accounting for more than one-third of total assets under management of offshore funds. It still dominates fixed income investment in Taiwan but has declined to 25% (as at end April 2018) reflecting growing concerns over the impact of the US rate hikes and the end of quantitative easing later this year by the US Federal Reserve. Cognizant of this risk, many have also reduced their investments in US fixed income funds (declined 8.4% year-to-date as at April 2018) and diversified into European fixed income funds (rose 10% over the stated period).

Nonetheless we believe the demand for fixed income products will continue in Taiwan where household disposable income hit a record high of more than USD505 billion in 2017. This is good news indeed given that a survey[6] of over 22,000 investors across 30 countries found that people in Asia place the highest priority in investing their disposable income over saving in a bank, purchasing property and paying off debt. Within Asia, Chinese and Taiwanese investors came out tops, 45% of investors in each of these two countries prefer investing, almost double the global average of 23%.

IMPLICATIONS FOR FINANCIAL SERVICE PROVIDERS

The preference for income yielding assets will grow in tandem with an ageing population. As the survey showed, the four Asian Tigers offer significant potential for rapid growth for income products over the next decade. Financial service providers will have to design unique products which allows individuals to assume greater responsibility for their own retirement as well as allow work and retirement flexibility. The survey also highlighted that most prefer to receive their retirement income in monthly payments rather than in a lump sum. The rationale being many fear outliving the lump sum amounts whereas a monthly payout is steady as well as stable and lessens dependence on family. This preference throws open opportunities for life insurance companies with regard to their annuity plans.

Ultimately, financial service providers should work alongside the government to prepare for the silver tsunami wave which will hit their shores sooner than later.

Sources: [1]United Nations, Population Division: World Population Prospects – The 2017 Revision (based on medium variants), as at June 2017. [2]World Economic Forum, We'll Live to 100 – How Can We Afford It, as at May 2017. [3]Data sourced from 2015 report titled "From Challenge to Opportunity" which was Wave 2 of the East Asia Retirement Survey conducted by by the Centre for Strategic and International Studies' (CSIS) Global Aging Initiative with the financial support from Prudential plc. The report is part of the multiyear Global Aging Preparedness Project, which was launched by CSIS and Prudential plc in 2010 with the publication of The Global Aging Preparedness Index, a unique new tool for assessing fiscal sustainability and income adequacy of retirement systems around the world. [4]Data sourced from 2012 report "The Future of Retirement in East Asia" which was the first wave of the East Asia Retirement Survey. Those aged 60+ are retirees. [5]Securities Investment Trust & Consulting Association (SITCA). [6]Schroders Global Investor Study 2017.

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