Full Report

Are Korean Consumers Ready for Retirement?

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Overview

Purpose

LIMRA and the Korea Insurance Development Institute (KIDI) partnered to examine the impact of population aging in Korea, the most rapidly aging country in the world.

Recommendations

- The life insurance industry faces slowing growth in the low interest rate environment. Companies need to turn their focus towards the aging population in order to remain relevant.
- Insurance companies need to suggest solutions for a more secure retirement.
- Companies should focus less on training general agents and more on cultivating financial consulting experts with a background in and knowledge about the accurate assessment of various institutions and financial products regarding the current situation of prospective retirement needs.
- Companies need to develop strategies to expand IRP (Individual Retirement Pension) because that market is likely to keep growing.
- Companies' services and product designs need to reflect the elderly's unique needs.
- In order to grow in the retirement market, insurance companies need to focus their marketing strategies, publicity, and education on people who are preparing for retirement.
- Government and the insurance industry need to collaborate in preparation for an aging society. Insurance companies need to encourage government support such as tax benefits for pre-retirees as in other countries.

METHODOLOGY This report synthesizes the perspectives of insurance professionals in Korea, obtained through interviews. The secondary analysis in this report utilizes data obtained by LIMRA, Korea Insurance Research Institute (KIRI), the Organization for Economic Co-operation and Development (OECD), World Health Organization (WHO), Korea Statics, and KIDI. The report also includes findings from informal interviews with life insurance professionals in Korea.

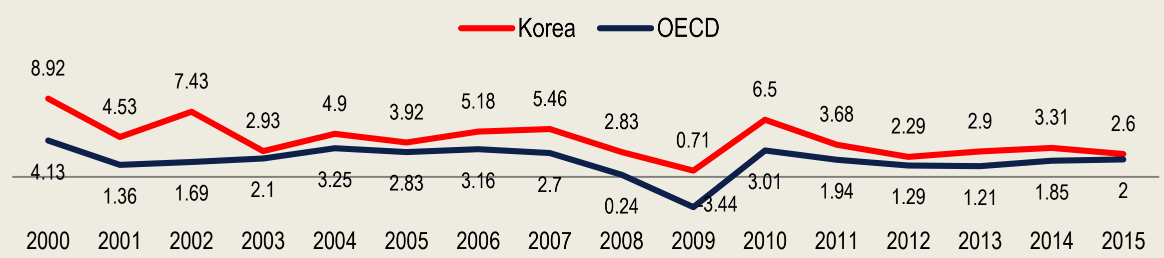
Economic Environment and Aging Trends

Economic Environment

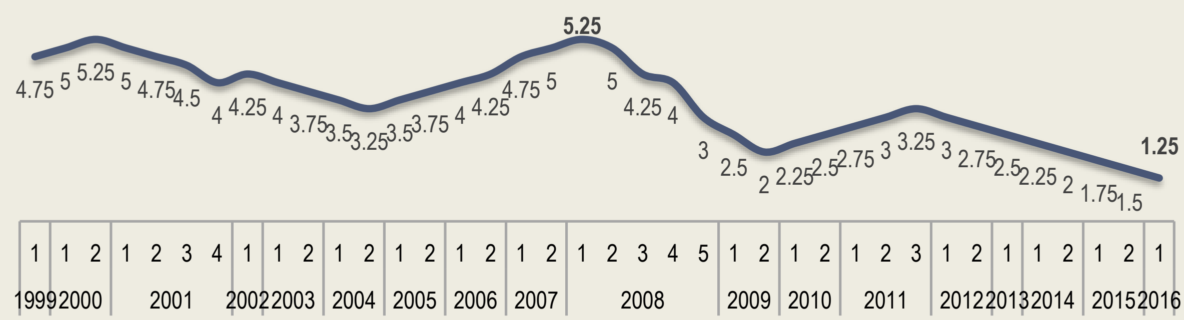
Korea is experiencing a spell of slow growth, low interest rates, and low fertility. According to the OECD[1], Korea has been one of the fastest growing OECD economies over the past 25 years. However, recent growth has slowed to a 2.75 percent annual rate over 2011-15. As a result of slower growth, consumer consumption is decreasing (Figure 1).

The interest rate in Korea has dropped from 1.5 percent to a record low of 1.25 percent. Life insurers are now finding themselves burdened by the long-term insurance products with fixed high interest rates they sold in the late 90s and early 2000s. Life insurers are facing considerable interest rates risk given their investments. Furthermore, the elderly (who are savers) and retirees wanting a stable and secure retirement, are increasing in numbers.

Figure 1 —
Economic Growth and Base Interest Rates in Korea



Source: http://stats.oecd.org/index.aspx?DatasetCode=POP_PROJ Historical population data and projections.



Source: The Bank of Korea

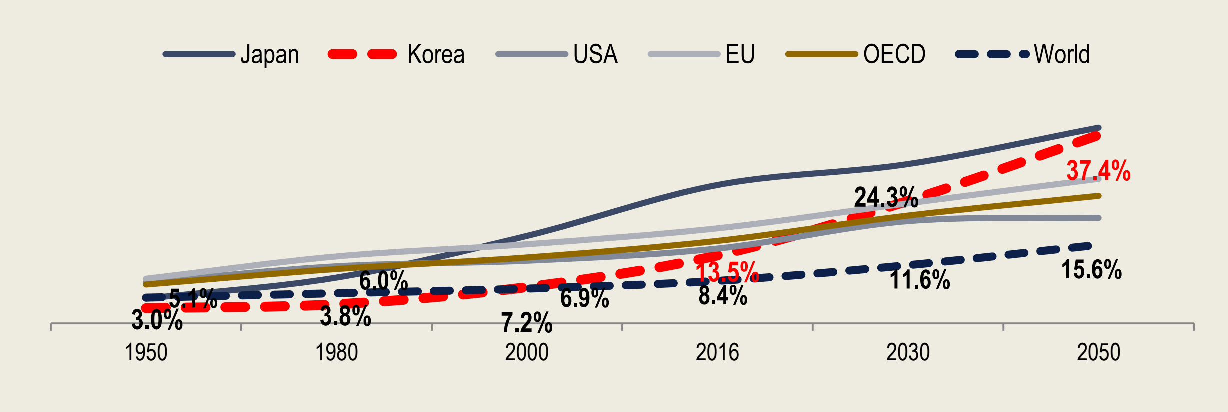
[1] The Organization for Economic Co-operation and Development (OECD) is an intergovernmental economic organization of 35 countries, founded in 1961 to stimulate economic progress and world trade.

Population Aging and Social Trends

If demographic trends continue, Korea will be an "Aged Society" with 14 percent of the population aged 65 or older by 2018 and a "Super Aged Society" (20 percent) by 2026.

According to OECD statistics, citizens aged 65 and older make up 13.5 percent of the total population in Korea today. Although the ratio of those aged 65 and over is currently lower than OECD numbers, it is growing more rapidly than anywhere else in the world. The OECD expects that Korea will become an "aged society" with more than 14 percent aged 65 and over by 2018. The ratio will increase to 24.3 percent in 2030, and is expected to rise to 37.4 percent in 2050. By 2026 Korea will become a "super-aged society," due to low fertility and the rapidly aging population (Figure 2).

Figure 2 —
Percent of Population Aged 65+

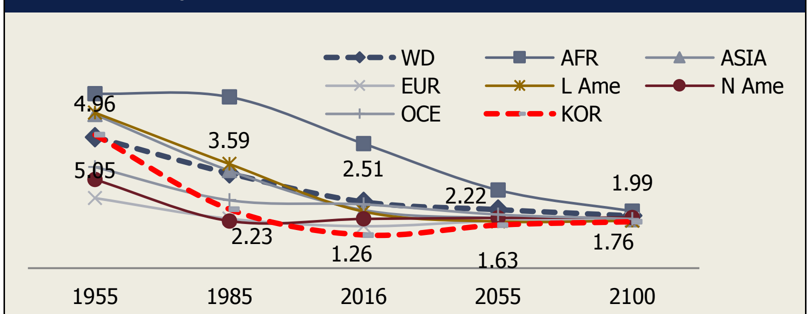


Source: http://stats.oecd.org/index.aspx?DatasetCode=POP_PROJ Historical population data and projections.

Sharp decline in fertility

Korea's fertility rate is 1.26, one of the lowest of all OECD countries. Fertility decline is causing serious problems including the accelerated aging of Korean society and a decrease in productive population. Korea has also had the highest rise in life expectancy in the world for the past three decades.

Figure 3 —
Trend of Fertility



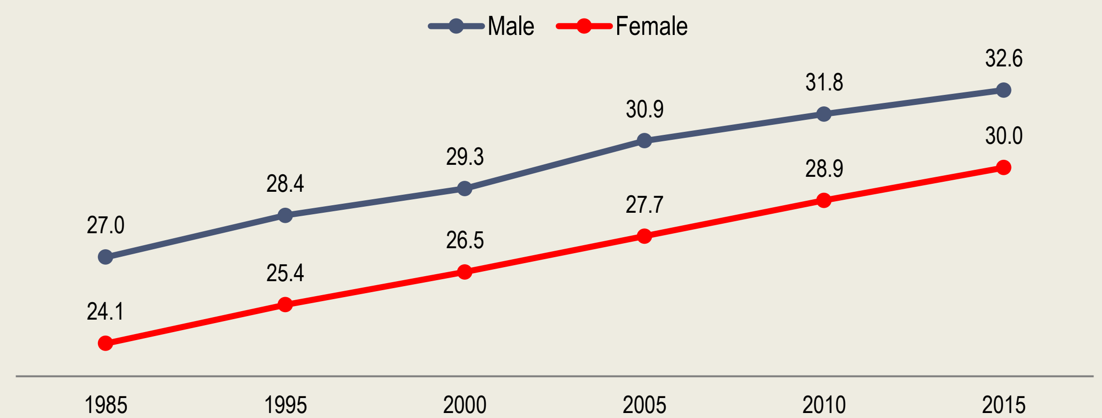
Source: OECD (the Organization for Economic Co-operation and Development) Historical population data and projection/United Nations, Department of Economic and Social Affairs, Population Division, 2016

Is low fertility a consequence of late marriage?

Koreans are getting married later and later in life (Figure 4). The mean age for men rose from 27 years in 1985 to almost 33 years in 2015 and from 24.1 years to 30 for women. According to the Seoul Foundation of Women & Family survey, the primary reasons for delaying marriage include:

- Economic independence (31%)
- Career development (24%)
- Child care burden (17%)

Figure 4 —
Mean Age at First Marriage

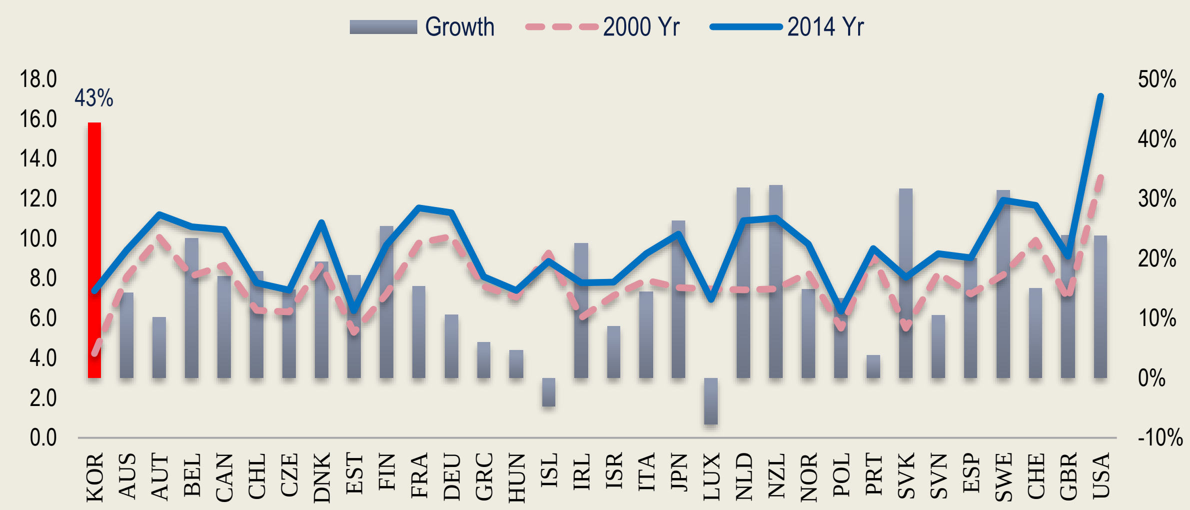


Source: Statistics Korea

Health expenditure per percentage of GDP is rising rapidly

Though the health expenditure of Korea is lower than in other countries, its growth rate has seen marked increases over the past 15 years (Figure 5). Korea's health expenditure is raising at the fastest rate in the world. This is expected to continue to increase because of Korea's aging society and the use of new and expensive medical technologies.

Figure 5 —
Trend of Health Expenditure

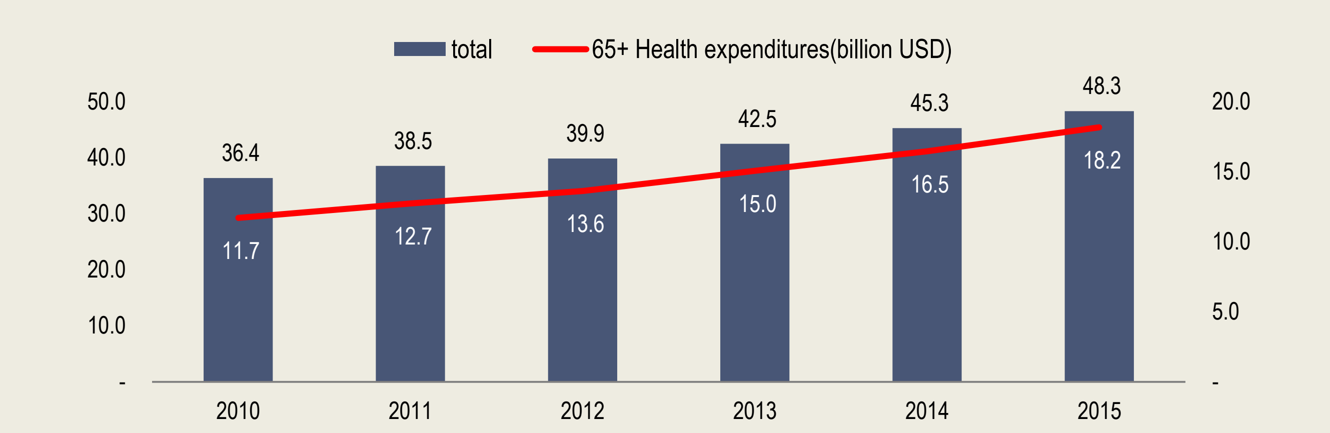


Source: World Health Organization
Note: Health expenditure, total (% of GDP)

Health Expenditures of Korean Elderly

In 2015, people aged 65 and over made up 13.1 percent of the total population and accounted for approximately 38 percent of the total health expenditures, which has increased at a steady rate of 5 percent since 2010.

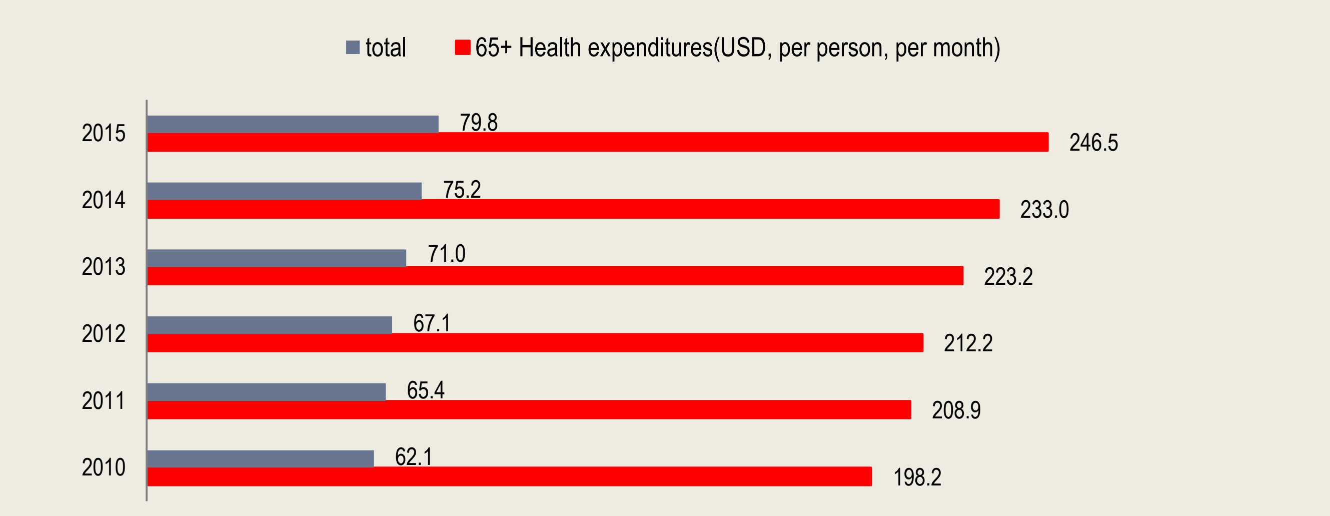
Figure 6 —
Trend of Health Expenditure for 65+



Source: Korea Health Insurance Review & Assessment Service 2015

The elderly population is severely burdened by health expenses. People aged 65 and over spend an average of 246.5 USD per month, which is three times higher than the overall average (Figure 7).

Figure 7 —
Trend of Health Expenditure per Month for 65+

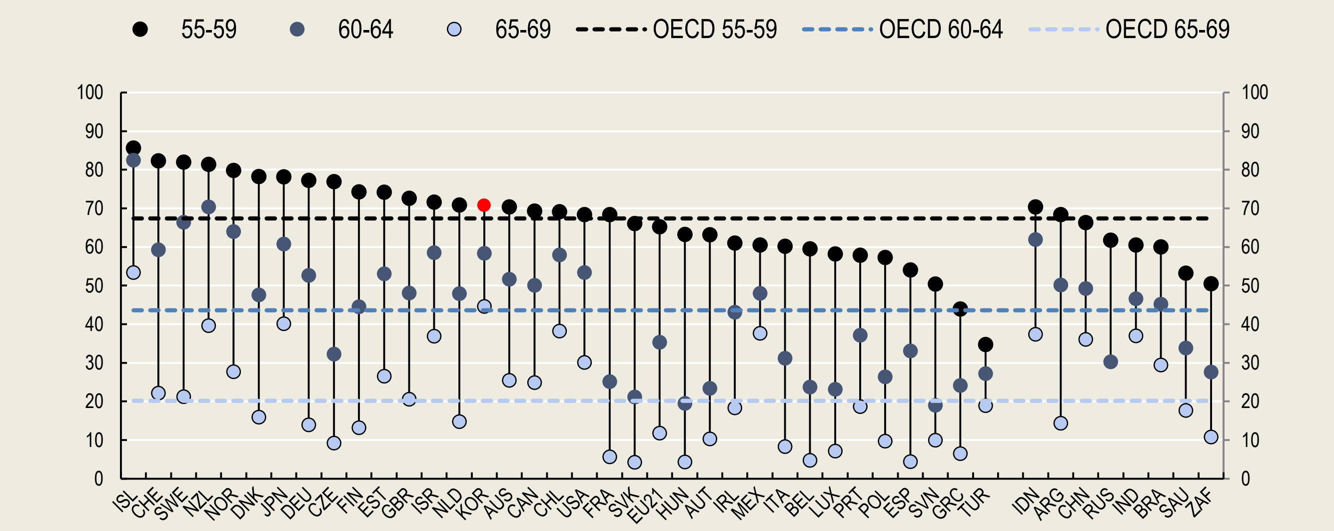


Source: Korea Health Insurance Review & Assessment Service 2015

Why do Korean elderly have to work longer?

According to the OECD, employment rates fall well before retirement age in all OECD and G20 countries. For individuals age 55 to 59, the average employment rate across all OECD countries was equal to 67.4 percent in 2014 (Figure 8). It was approximately 44 percent and 20 percent for those aged 60-64 and 65-69. The employment rates in Korea are higher than the OECD average for all ages at 70.8 percent, 58.3 percent, 44.5 percent respectively. In 2014, Korea displayed the second highest rates for 65-69 year olds.

Figure 8 —
Employment Rates of Workers Aged 55-59, 60-64 and 65-69 in 2014



Source: Employment Outlook, OECD, 2015

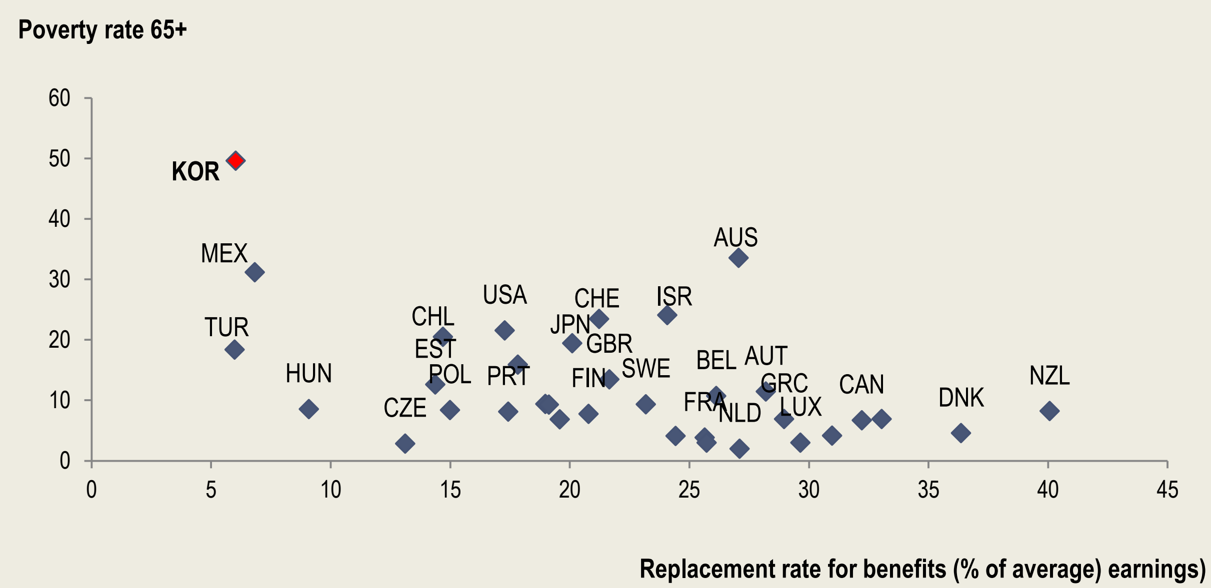
Note: Employment rates for non-OECD G20 countries are latest available.

What brings Korean elderly into poverty?

Despite Korea's rapid economic growth, the elderly poverty rate is the highest among OECD countries. About half of Korea's elderly (49.6 percent of those aged 65+) live in relative poverty, which is four times higher than OECD average of 12.6 percent. According to the OECD, the average poverty rate across countries among ages 67-75 is 11.2 percent and 14.7 percent for those over age 75.

In 2014, most people living in poverty were relying on the National Basic Pension which is 200,000 KRW (6.2 percent of the average wage, US$ 167). Korea has one of the lowest net pension replacement rates among OECD countries. Perpetuated by deteriorating health and early withdrawal from the labor market, lack of financial security is a significant threat to the wellbeing of Korea's rapidly aging population. Korean elderly are the most likely to fall into poverty during retirement (Figure 9).

Figure 9 —
Replacement Rate of Benefits and Poverty Level of Individuals 65 or Older

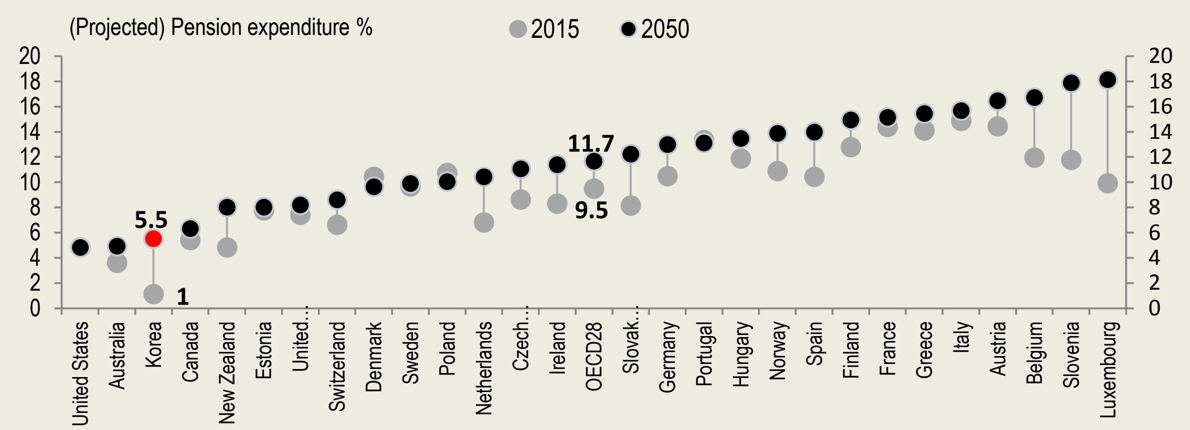


Source: Pension at a glance, OECD, 2015

Can the Korean government continue to support the elderly?

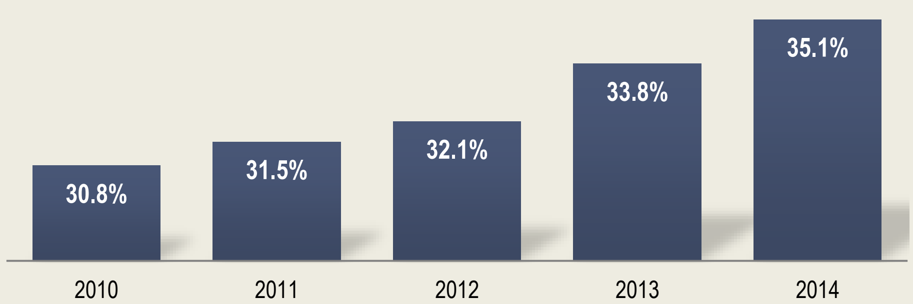
Figure 10 shows the projected increase of pension expenditure from 2015 to 2050. Due to high government debt (Figure 11) it will be very challenging to support the elderly population in Korea's near future. The government recorded a debt of 35.12 percent of the country's gross domestic product in 2014, up from 30.8 percent in 2010.

Figure 10 —
Projections of Public Pension Expenditure as a Share of GDP From 2015 to 2050



Source: OECD Pensions Outlook 2014

Figure 11 —
Government Debt to GDP in Korea



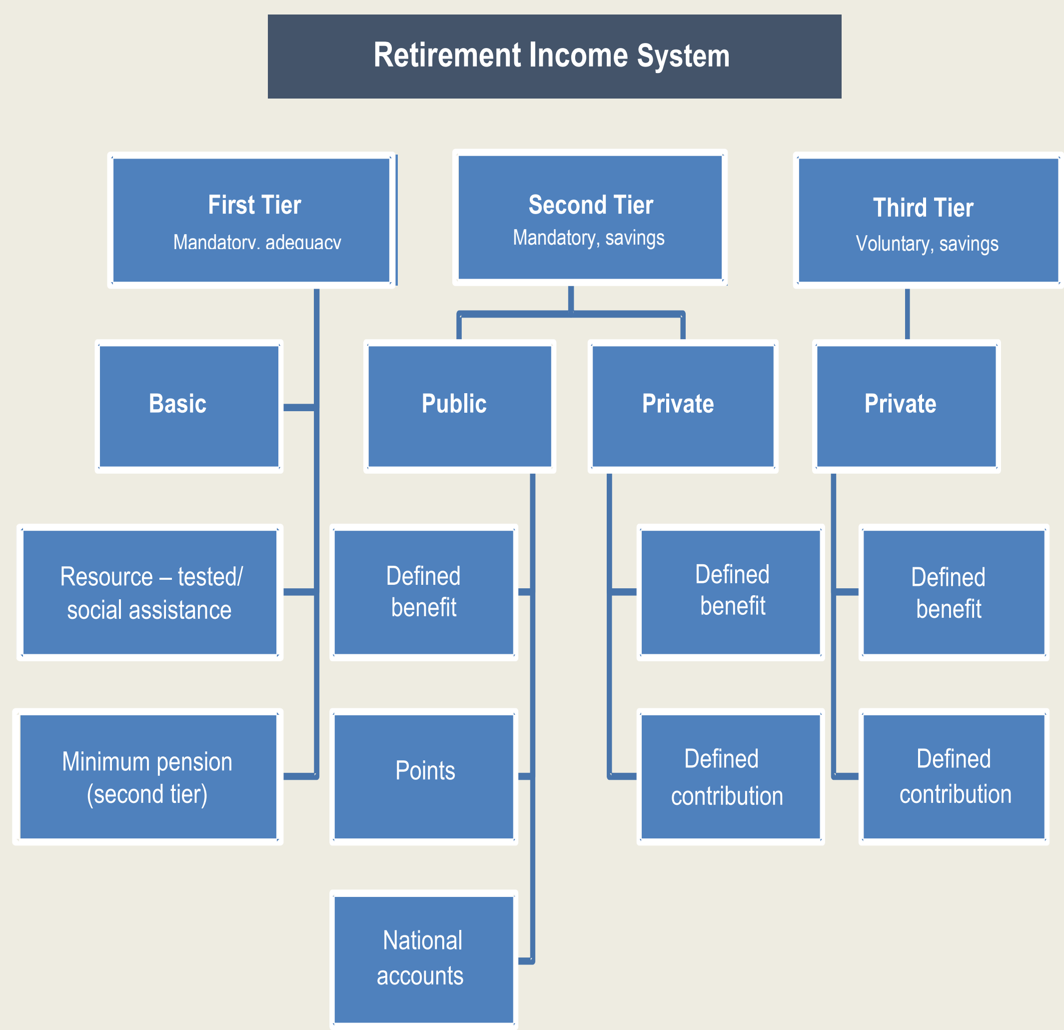
Source: Ministry of Strategy and Finance, South Korea

Pension Scheme

Pension systems and structure

Pension systems are classified according to the OECD pension taxonomy (Figure 12). Adequate benefits from mandatory plans would reduce the need for additional reliable income streams. Conversely, insufficient benefits would cause people to seek private annuity products in order to meet regular living expenses. Retirement income systems and taxonomies vary across countries.

Figure 12 —
Different Types of Retirement Income Provision and Structure of Retirement Income Provision

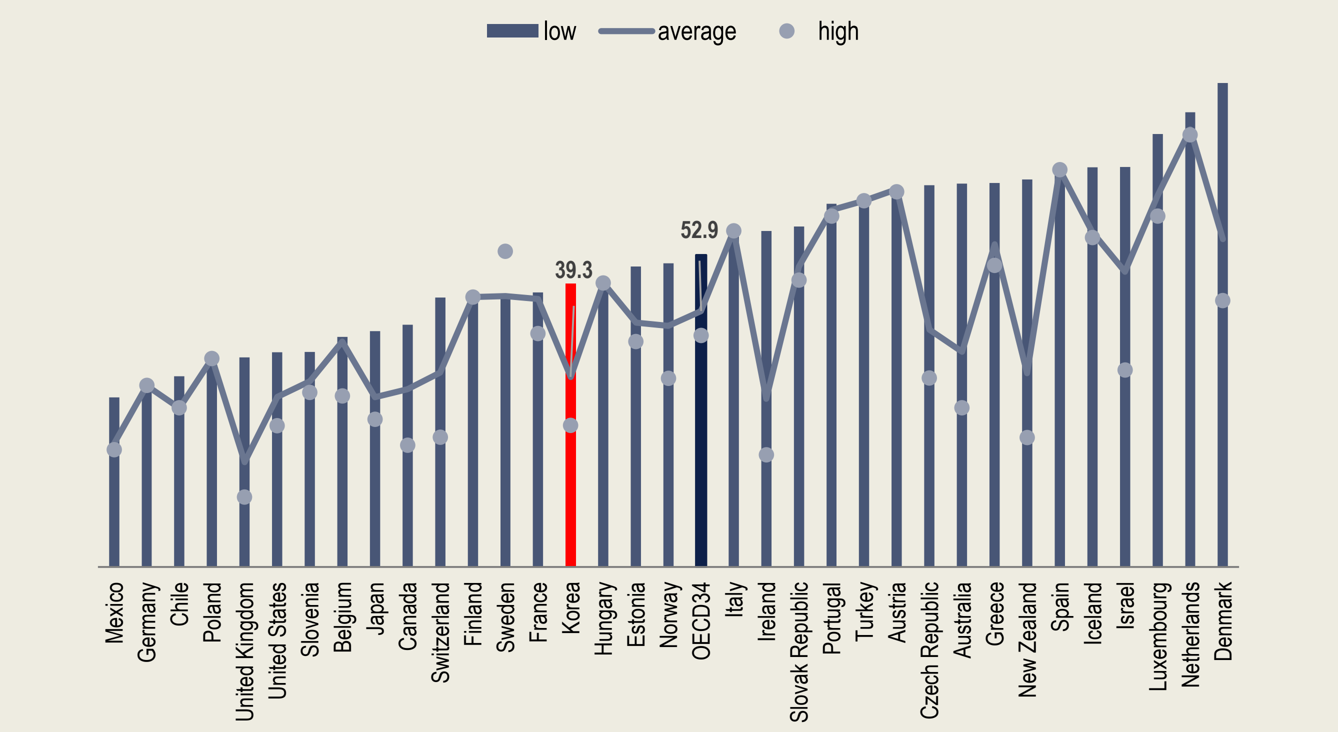


Source: OECD Pensions at a Glance 2015
Note: DB = Defined benefit; DC = Defined contribution; NDC = Notional accounts

Korean public pension benefits are available to anyone over age 60, provided they have contributed for at least 10 years. The pension age is gradually being increased to reach age 65 by 2033. The gross replacement rate shows the level of pensions in retirement relative to earnings when working (Figure 13). For workers with average earnings, the gross replacement rate averages 53 percent in 34 OECD countries. Korea, however, offers a replacement rate of less than 40 percent for the average worker.

OECD countries are gradually shifting their focus to the annuity market in order to minimize the government's role in retirement funding.

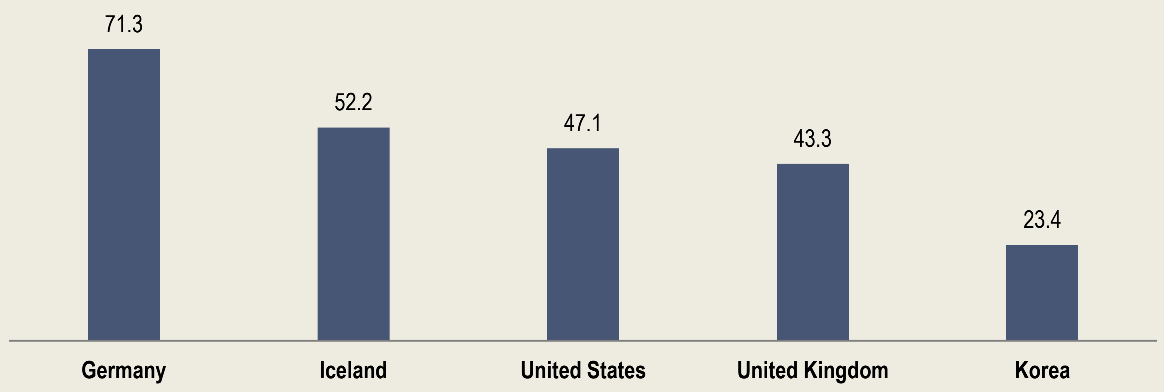
Figure 13 —
The Gross Replacement Rate



Source: : Pension at a glance, OECD, 2015

Coverage by private pension in Korea is low (Figure 14). The total pension savings in 2013 was 9 trillion KRW (US$ 750 billion) in premium volume and declined to 8.8 trillion KRW (US$ 733 billion) in 2014. Private pension premiums have fallen to 8 percent. The government needs to expand the private pension market, following more developed models, such as the U.S. Individual Retirement Accounts (IRAs).

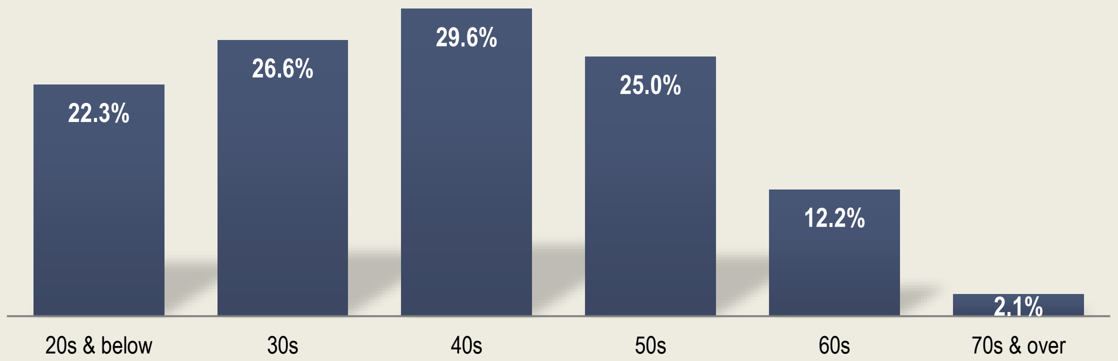
Figure 14 —
Coverage of Private Pension Schemes



Source: OECD
Note: As a percentage of working-age population (15-64 years)

Penetration of private pensions in Korea was 17.1 percent in 2013. Even though it increased 1.4 percent from the previous year, it is still low. Results showed that individuals in their 40s are the most likely to have a private pension plan (Figure 15). It is necessary to attract younger generations through active promotion and education of the benefits of private pension plans.

Figure 15 —
The Pension Gap



Source: KIDI

Suggestions

1. Work with financial professionals (FPs) and formal written retirement plans (FWPs)

Most retirees and pre-retirees depend on self-estimating their income and assets for retirement. For those without an FP or family member who works with one, reliance on national pension (Social Security) is very common. According to a KIDI survey, 65 percent of responses regarding the need for financial professionals' assistance are negative. The two major reasons: They can't afford it (49 percent) and they don't see the benefit of services (21 percent).

In contrast to Korean respondents, 58 percent of U.S. respondents work with an FP.
In terms of financial professional types, 69 percent prefer to work with a financial advisor or planner in USA. The remainder work with an individual who specializes in investments (19 percent), a mutual fund agent (3 percent), an insurance agent (2 percent), or an advisor at a bank (2 percent).

Formal written retirement plans (FWPs) are instrumental in accomplishing critical planning activities.
The top risks managed through FWPs are inflation (71 percent) and health care costs (66 percent). In the U.S., individuals are comfortable referring their FP to friends/family and would like to work with an FP for rest of their lives.

Insurance companies should cultivate the skills of financial consulting experts.
Rather than focus on training general agents, insurers should develop a team of individuals with in-depth knowledge about financial products and retirement needs. Consumers need professional consulting services that are transparent and trustworthy for them to feel comfortable with the idea of retirement planning, and in turn, a secure retirement (Table 1).

Table 1 — Work with FP

	Estimated how many years assets will last	Calculated the amount of assets available to spend	Has plan for generating income from savings
No FP, No FWP	36%	53%	29%
Have FP, No FWP	48%	62%	46%
No FP, Have FWP	74%	78%	75%
Have FP, Have FWP	83%	86%	79%

Source: The Benefits of Retirement Planning, LIMRA, 2016

2. Focus on expanding individual retirement pension

The Korean government enacted the Employee Retirement Benefit Security Act (ERBSA) which introduced defined benefit (DB), defined contribution (DC) and individual retirement account (IRA) plans. The government introduced the IRA in 2005 as a way to eliminate lump sum payouts and ensure a more stable retirement for individuals. But because the IRA was optional, it was not fully utilized.

To increase success, the government imposed a mandatory individual retirement pension (IRP) sign-up. In 2013, they also allowed tax benefits for retirement to be granted before the age of 55. The IRP was designed to attract retirement money in exchange for tax benefits. It came from the same idea as an IRA, however, the IRP is mandatory for the organizations that have it in place. Despite the 30 percent tax benefit, it is still not popular in Korea.

IRP has gone from a tax deduction to a tax credit. Korea changed the tax incentives for private pensions from a tax deduction to tax credit in 2014. A tax credit is given up to 7 million KRW (US$ 5,833). In the United States, traditional IRAs permit up to a statutory annual limit of US$ 5,500. People aged 50 and older are permitted $6,500 through a special “catch-up” policy. IRP is a broader definition of IRA and will eventually replace IRAs in United States. It is more flexible than an IRA in that it allows for previous DB and DC.

IRP offers opportunities for market expansion. According to KIRI, 28.5 percent of Korean workers currently have an IRP and an additional 33.8 percent are willing to join one. The portion of individual IRP increased from 7.5 percent in 2012 to 9 percent in 2016.

Life insurers should get on board. In 2015, life insurance sales increased from 4.1 percent to 4.9 percent. Life insurance companies should focus on selling the concept of IRP to help expand the Korean retirement market. It is necessary to use more aggressive marketing promotions and educational outreach programs to encourage individuals to save via an IRP.

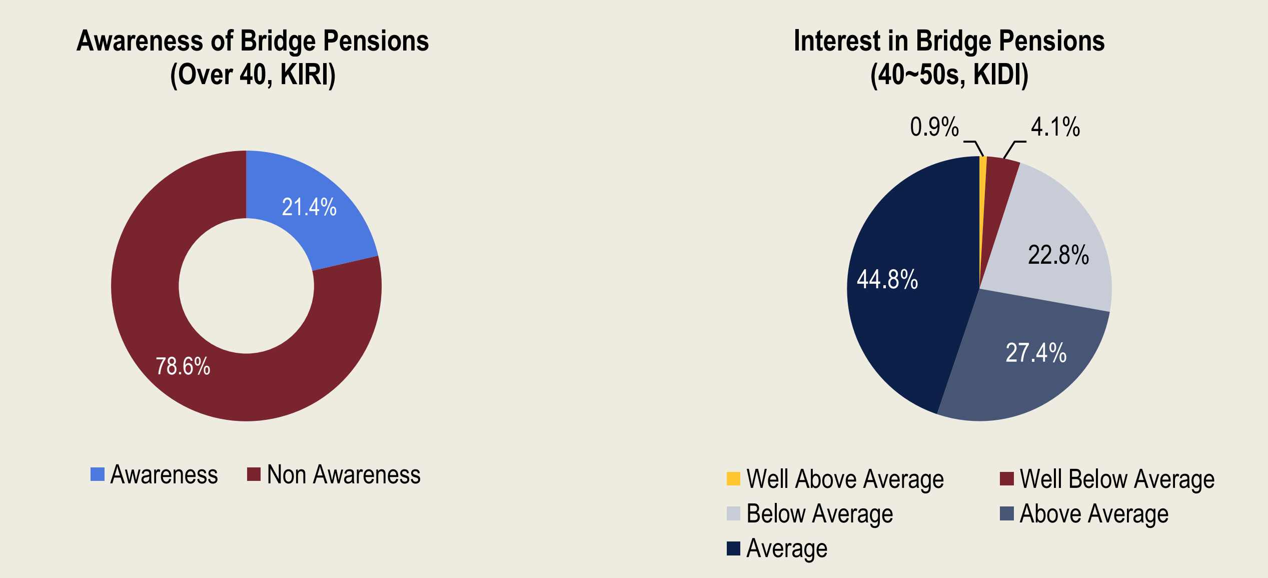
3. Bridge pension

Though the official retirement age of a permanent (regular) job is 60, the average retirement age for an office worker is 53 due to layoffs.

For Korean workers born in 1969 or earlier, the national pension (Social Security) system is available to them upon reaching age 60, provided they have contributed for at least 10 years. The official retirement age for people born after 1969 will be 65 years, delaying the onset of their pension benefits until that time. There is a gap in pension benefits of at least five years between the age of eligibility for a national pension and actual retirement age.

In many cases, the elderly are still working as temporary workers to support themselves after their official retirement. The actual retirement age to maintain the minimum cost of living for Korean men is 71.1 according to a recent OECD survey, putting the country second highest where retirement awareness is one of the lowest of developing economies across the world. In order to maintain a stable life after retirement, people should consider bridge pensions. According to the KIRI retirement readiness survey, 78.6 percent are unaware that bridge pensions even exist. In order to expand the bridge pension market, life insurance companies need to increase publicity and education for pre-retirees (Figure 16).

Figure 16 —
Awareness of and Interest in Bridge Pensions



Source: Korean Life Insurance Market, An Overview of Sales and New Issues, KIDI & LIMRA, 2016.

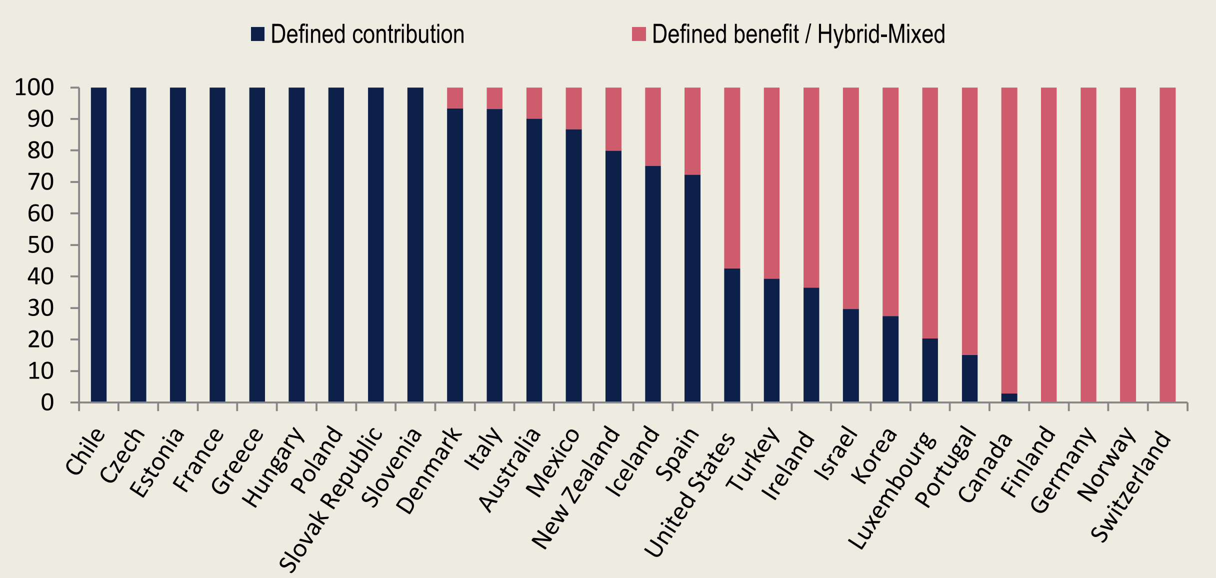
4. Hybrid Pension

In a low-interest-rate environment, companies using DB schemes are financially burdened.
There is a shift toward DC pension schemes, but there is also concern about retirement loss. As an alternative, companies and employees are turning to hybrid DB/DC plan models. This will help them to gain a more balanced approach, reducing their singular reliance on, and avoiding the financial risks of the traditional DB plans of the past.

Life insurance companies should focus on DC plans to grow the retirement market.
A prolonged period of low interest rates has negatively impacted both DB and DC schemes. The DC portion has increased from 17.8 percent in 2012 to 23.4 percent in 2015. The growth rate of total financial institutions has increased 5.6 percent while life insurance has increased just 2.5 percent.

In the U.S., cash balance plans are getting attention.
A cash balance plan is a defined benefit retirement plan that maintains hypothetical individual employee accounts like a defined contribution plan. The hypothetical nature of the individual account was crucial in the early adoption of such plans because it enabled conversion of traditional plans without declaring a plan termination (Figure 17).

Figure 17 —
Relative Shares of DB, DC and Hybrid Pension Fund Assets



Source: OECD 2015
Note: As a percentage of total assets

5. Design products to reflect the specific needs of the elderly

Baby Boomers in Korea are most concerned about their health and financial security.

To alleviate these concerns and to enjoy their desired lifestyles, Boomers should take appropriate action to determine the best use of their life insurance policies. Ninety-three percent of pensioners selected a lump sum payment instead of receiving a pension (December 2015)[2]. Insurance companies should be paying particular attention to the trend of lump sum payouts. According to a 2014 KIDI survey, Baby Boomers consider annuity (30.2 percent), medical insurance (20.0 percent), and LTC (long-term care insurance, 16.4 percent) most often.

Create easy-to-understand life products with savings components.

Boomers seek simple products that are easy to understand, explicit, and transparent. The Insurance Information Institute recommends that Baby Boomers consider buying a life insurance policy or extending an existing policy, which can fulfill financial obligations after death and provide financial aid to spouses, children, or even parents. Insurers should consider marketing whole or universal life insurance, which include savings components, to meet these needs.

Expand annuity options.

Annuities include death benefits, but also provide protection against "out-living" one's finances. Essentially, a life insurance policy provides economic protection to loved ones, while annuities protect the individual and his or her family during life. There are several annuity options and product add-ons based on an individual's long-term goals. Korean life insurance companies should develop a greater variety of products, following the U.S. product development trend, in order to meet the elderly's unique needs for a secure retirement.

[2] KIDI survey, December 2015.

6. Publicity and Education

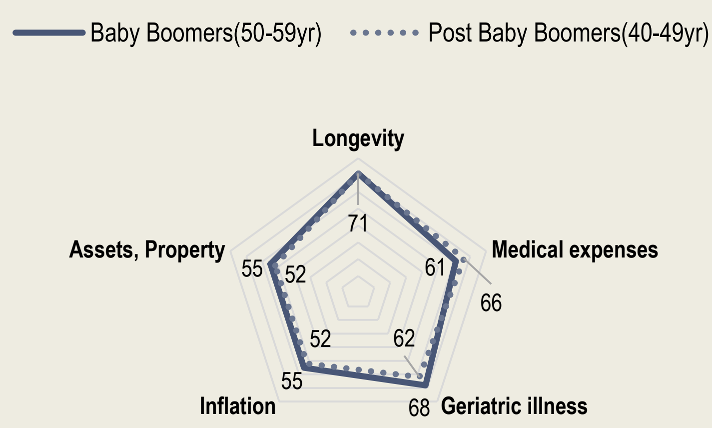
Awareness of aging is high, but preparation for retirement remains low.

A global trend to deal with an aging society is to strengthen private pensions, not government support**.** According to a KIDI survey, Baby Boomers are more concerned about their longevity, medical expenses, and geriatric illnesses than financial security risks such as assets, property, and inflation. Despite a high awareness of potential health issues, they lack preparation for dealing with these risks (Figure 18).

Insurance companies need to provide information, publicity, and education to help and encourage pre-retirees to invest in insurance products.

The Riester pension in Germany is tax-promoted and subsidized by the government. The modeling assumes a contribution rate of 4 percent. It is a voluntary — but heavily subsidized — private pension scheme for lower income people. It is designed as a matching defined contribution scheme that can fill the emerging "pension gap" and gives more benefits for low income and large families.

Figure 18 — Perception of Risk

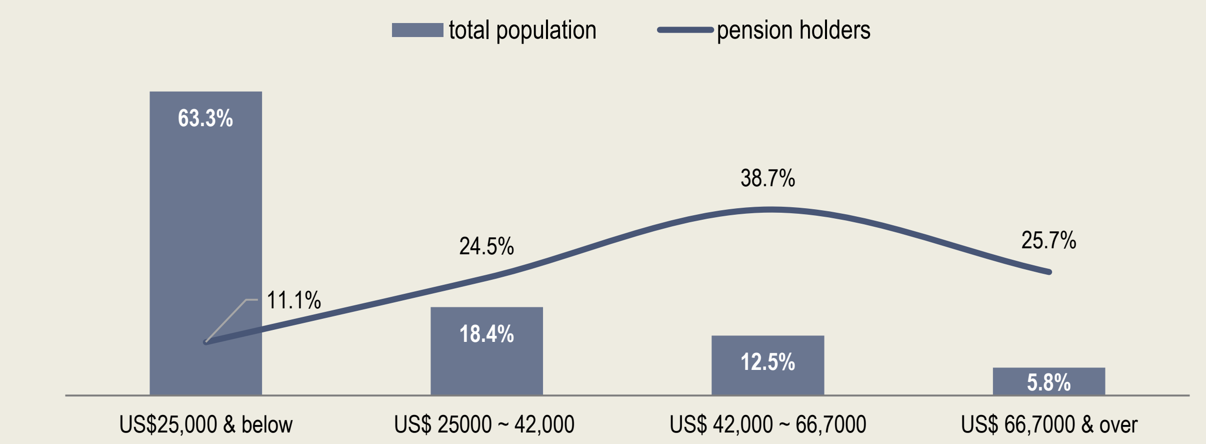


Source: KIDI

Korea changed the tax incentives for private pensions from a tax deduction to tax credit in 2014. As a result, the rate of private pension coverage declined. The low-income class, which is US$25,000 or below, represents 47.5 percent of the total population, but the pension rate is only 3.8 percent. These aggressive government incentives need to serve the lower-income class.

In order to secure tax revenue, Korea has changed the tax incentives for private pensions from a tax deduction to tax credit in 2014. Deductions reduce taxable income therefore their value depends on the taxpayer's marginal tax rate, which rises with income. Tax credits are subtracted not from taxable income, but directly from a person's tax liability. The deduction reduces tax liability by the amount of the deduction times the filer's marginal tax rate, and is thus worth more to taxpayers in higher brackets (Figure 19).

Figure 19 —
The Rate of Private Pension

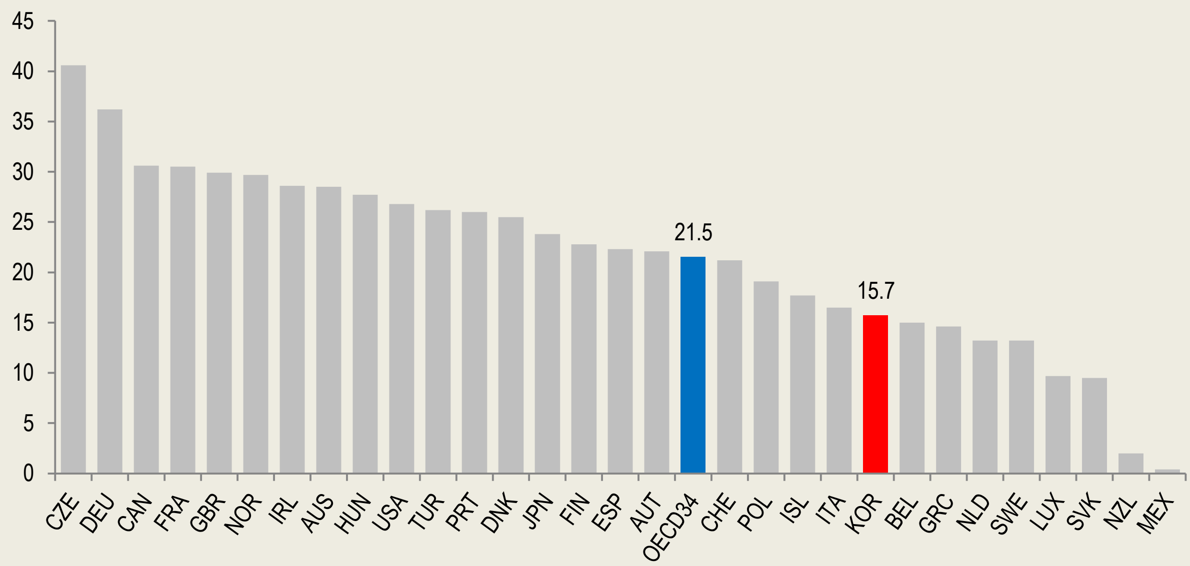


Source: : KIDI

Increase Tax Incentive

The tax incentive of Korean government in terms of pension is only 15.7 percent, ranked 23 among OECD 34 countries. It is lower than the U.S. (26.8 percent) and Japan (23.8 percent). In Korea, a tax credit is given up to 7 million KRW (US$ 5,800). In contrast, the U.S. government asks that taxpayers contribute up to $18,000 (2015). The catch-up contribution limit for employees aged 50 and over who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is increased from $5,500 to $6,000 (Figure 20).

Figure 20 —
Tax Incentive of Contribution



Source: OECD 2013

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