CAN STATUTORY FUNDED PENSION SCHEMES BENEFIT FROM AN EU REGULATORY FRAMEWORK?

Pablo Antolin
OECD Financial Affairs Division
YES, IT IS NECESSARY
THE OECD HAS DEVELOPED A ROADMAP FOR THE GOOD DESIGN OF RETIREMENT SAVING PLANS
Why is it necessary?

- Shift **from** plans in which benefits are pre-determined (DB) and plan sponsors or the State assume most of the risks **to** plans in which benefits depend on assets accumulated and individuals bear most of the risks
Positive and negative features of DC

Positive feature of DC plans: direct and straightforward link between pension benefits and contributions

Negative feature: risk squarely onto individuals, who may not be best prepared to bear them
The background of the shift compounds the problem

- Additionally, shift accompanied by lower contributions
- Low financial literacy
- People unable or unwilling to make choices
- Worries about adequacy and protection
Challenges: large volatility of retirement income in DC plans
These plans are becoming one of the main sources to finance retirement in many OECD countries.

Need to make sure these plans are properly designed in order to improve the adequacy of retirement income stemming from this plans.

WPPP approved and endorsed OECD Roadmap for the Good Design of Retirement Saving Plans
Guiding principles

• The set of policy options are established according to three *guiding principles*:
  – Coherence
  – Adequacy
  – Efficiency
Coherence

• The design of DC pension plans need to be **globally** coherent: coherence with the overall structure of the pension system
• And **internally**: the accumulation and the payout phases need to be properly aligned
• Coherence in monitoring all risks affecting retirement income in DC plans
Adequacy

- DC pension plans are *complementary* to other sources to finance retirement (e.g. PAYG-financed pensions).
- They are an integral part of total retirement income.
- DC plans need to be designed (e.g. contribution rates, contribution periods, payout phase, etc.) taking into account that they may provide a retirement income that complement other sources up to the target overall retirement income.
Efficiency

• Efficiency means choosing investment strategies that reduce the impact of extreme negative outcomes on retirement income.

• There are many investment strategies to choose from in the return-risk spectrum.

• If main concern (policy makers) to avoid sharp declines in retirement income as a result of extreme events (e.g. 2008 crisis), then they will set default investment strategies that avoid or limit these sharp drops, in particular for people close to retirement.
Efficiency

- Efficiency is also required to properly structure the payout phase.
- Assets accumulated must be allocated to protect retirees from longevity risk.
- Among payout options, programmed withdrawals provide greater flexibility and liquidity, while life annuities provide better protection from longevity risk.
- Strike balance
Actions policy makers should take

1. Ensure the design of DC pension plans is **COHERENT**

2. Encourage high participation rates, adequate contributions and long contribution periods (contribute enough and for long periods)

3. Promote well-designed incentives, in particular voluntary systems

4. Promote low-cost retirement savings instruments
5. Establish appropriate default investment strategies, but also provide individuals with a choice of funds with different risk profiles and investment horizons

6. Use life-cycle strategies as the default option to protect people close to retirement against negative outcomes
   - Easy to understand, protection worst cases
   - Not panacea: unclear better normal times, inadequate or low pensions, volatility
Actions policy makers should take

7. Encourage annuitization as a protection against longevity risks

8. Promote the supply of annuities, innovation and cost-efficient competition in the annuity market

9. Develop risk-hedging instruments to facilitate dealing with longevity risk

10. Ensure effective member communication and address financial illiteracy
THANK YOU VERY MUCH

www.oecd.org/insurance/private-pensions