OPSG

OCCUPATIONAL PENSIONS STAKEHOLDER GROUP

Advice on Defined Contribution Principles – Proposals for Good Practices

EIOPA-OPSG – 21-33

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INTRODUCTION

This position paper is prepared by EIOPA Occupational Pension Stakeholder Group (OPSG) as a general input to EIOPA's plans to commence work on Defined Contribution Pensions – Proposals for Good Practices. The plans were outlined to the OPSG at its meeting on January 27th 2021. Subject to approval by EIOPA's Board, it is planned to start the work in Q4 of 2021. In Q1 to Q3 EIOPA plans preliminary informal Stakeholder engagement. The purpose of this engagement by EIOPA is to:

- Take stock of relevant external work, and
- Gather ideas and suggestions

This paper is a reflection paper intended to give initial thoughts on the issues raised that will assist EIOPA in the planning of the work.

This paper is prepared by a working party and has been approved by the OPSG on…., 2021.

REFLECTION

The stated objective of the proposed work "to provide principles and good practices on the design of sustainable and adequate occupational DC pensions" is welcome and EIOPA is well placed to carry out this work. We also welcome the proposed building block approach which would leave Member States flexibility to tailor principles and best practices to national specificities.

The building block approach was outlined in the following table:

Building blocks	Core questions
Manage the shift away from DB to DC	Extent to which forms of risk sharing work in DC considering balance between adequacy and sustainability, respect of DC product attributes, intergenerational balance and transparency?
Make occupational DC pensions moreengaging with members	Constituents of adequate occupational DC pensions, principles of scalability and profitability for DC, behavioural and cognitive barriers, extent some pension flexibilitiesand ESG strategies can improve engagement?
Future-proof occupational DC pensions	Pension design adapting to evolving demand and supply e.g. self-employed/gig workers,portability and small pot issues, flexibility between 2nd and 3rd pillar, digitalisation?
Guide the transition to retirement	Principles and practices for the design of adequate decumulation strategies tailored toretirement income profiles (U-/J- shaped) and considering people's behavioural and cognitive biases?
Protect future beneficiaries	Principles of sound risk-based prudential and supervisory framework fosteringsustainable and adequate occupational DC pensions?

In terms of the Building Blocks and the core questions posed, we make the following observations:

Block 1: Managing the shift away from DB to DC

It should be remembered that many countries do not have, or have never had, DB pensions. Therefore, it will not always be about managing the shift, but focusing on DC as the means of pension provision.

Core Question:

Extent to which forms of risk sharing work in DC considering balance between adequacy and sustainability, respect of DC product attributes, intergenerational balance and transparency?

These are key and important issues and should be examined.

- The design of DC pension systems should take into account the respective role that the authorities expect that first pillar pensions, any existing DB pensions, and occupational and personal DC pensions should plan to achieve retirement income adequacy.
- A high degree of ambition regarding the role that DC pensions should play should be supported by measures such as mandatory enrolment, automatic enrolment with opt out clause, appropriate tax incentives and adequate explanations.
- The authorities should encourage people to start saving early in their career, even small amounts, to benefit from the law of compound interest, and ensure that the target retirement income is supported by sufficient total contributions from members and their employers under occupational DC plans.
- Special attention should be given to low-income earners, who have less financial capacity and may lack financial literacy to save a lot for retirement. This situation can be addressed by ensuring that first pillar pensions are particularly generous towards this group of people. Where this is the case and, for example, there is a minimum guaranteed first pillar pension, it may be appropriate not to include people earning below a prescribed limit. However, it also needs to be considered that people may have more than one employment and their total earnings should be considered.
- To ensure adequacy, it is crucial that the DC pension system is founded on robust and transparent governance rules as well as efficient risk mitigation techniques over the long term. A high level of disclosure of costs and past performance is also required to ensure that market forces lead to pressure on fees, as a result of transparency and the ability to compare costs.
- The system in place should allow for the co-habitation between low-cost solutions and DC pensions offering some specific features bringing better value for money to participants.

Block 2: Make occupational DC pensions more engaging with members

This is a key area and should also consider the purpose of engagement. It is important that members understand their pensions and how they work. It can also be important to offer members the appropriate level of engagement, particularly for example, in making investment decisions. It would be useful to examine the balance between giving individuals choice and making decisions on their behalf or offering efficient default options.

Core Question:

Constituents of adequate occupational DC pensions, principles of scalability and profitability for DC, behavioural and cognitive barriers, extent some pension flexibilities and ESG strategies can improve engagement?

We would suggest adding “adequate educational information” to the core question. This should also look at the use of technology and digitalisation as a means of getting members more engaged. It is, however, important to ensure that people relying on new technologies to start saving in DC pensions are no less protected than when resorting to face-to-face meetings to receive advice on how much to save and in which products (in the case of voluntary personal pension saving), but face to face meetings come at a cost.

The work could also examine how best to engage with members with disabilities that might impact their ability, for example, to read or understand. Can technology help rather than further compound their issues?

Finally, it may be useful to consider the solutions taken to ensure effective communication to savers in the PEPP in the PEPP KID and the PEPP Benefit Statement, including the use of layering to present information. Similarly, it may be useful to evaluate the experiences and good practices developed where DC pension schemes are already marketed.

Block 3: Future-proof occupational DC pensions

This is a really key area and it is important that DC pensions are well designed and robust but also adaptable to a changing environment, particularly as the nature of work is likely to continue to evolve.

Core Question:

Pension design adapting to evolving demand and supply e.g. self-employed/gig workers, portability and small pot issues, flexibility between 2nd and 3rd pillar, digitalisation?

This should also focus on the administration of DC to ensure it is flexible enough to evolve. DC administration involves recording large numbers of transactions and it is important that administration systems are properly planned and resourced to be adaptable. We would also suggest that investment solutions targeting net positive return after inflation in the on-going low interest rate environment are a key part of future-proofing DC pensions.

Block 4: Guide the transition to retirement

This is key to ensuring DC pension achieve their purpose of providing good pensions in retirement. There are wide disparities where the focus can just be on delivering a fund at retirement to solutions that keep members in the DC pension through retirement. The design of the pay-out phase should take into account a holistic view on the role that DC pensions should take in protecting members against the longevity risk. In countries where first pillar pensions aim at ensuring pension adequacy the need for annuitisation of accumulated DC savings may be less desirable, especially in the context of voluntary saving. There is indeed a trade-off between the goal of providing adequate protection against longevity risk and individuals' desire to maintain control on their savings.

Core Question:

Principles and practices for the design of adequate decumulation strategies tailored to retirement income profiles (U-/J- shaped) and considering people's behavioural and cognitive biases?

There is a lot of evolving research in this area looking at combining those areas of individual needs in retirement and the ability to make informed and appropriate decisions. The risks, where members have control, can range from running out of funds during retirement to underspending in retirement. The role of advice, collective arrangements, annuities including deferred annuities and programmed withdrawals should be examined, taking into account all sources of pension income, the cost of the protection, and the impact of the current low interest rate environment.

Block 5: Protect future beneficiaries

Core Question:

Principles of sound risk-based prudential and supervisory framework fostering sustainable and adequate occupational DC pensions?

It would be useful to look at the costs and benefits of regulation, particularly what is appropriate for different types of DC models.

There should be provisions in place to deal with the run-off or wind-up of DC plans. These can occur due to failure or exit of sponsors or administrators or regulatory intervention. Often, the only assets of these plans are the participants' accounts and they should not have to bear the cost of a run-off or wind-up. In many other cases capital reserves are still available and it must be guaranteed - mostly by supervisory intervention - that these capital reserves will be distributed as fairly as possible amongst the current and prospective beneficiaries in the long run.

Additional Block: Investment strategies

It is essential that the blueprint for sustainable and adequate DC pensions include a block dealing with investment strategies. This block should deal in particular with:

- the design of default strategies
- the choice that should be given to people willing to choose their investment strategy

Relevant External Work or Country Experiences

EIOPA asked for examples that could be examined. Some that we suggest are:

- The PEPP Regulation, which is intended to offer a state-of-art approach to regulating personal DC schemes. One of the distinctive contributions of the project should highlight differences between good practices in personal and occupational DC schemes.
- The OECD work in the area of DC pension plans, including the draft Roadmap for the Good Design of DC Pension Plans, on which a public consultation has been launched (https://www.oecd.org/pensions/designingfundedpensionplans.htm).
- Country level experience
    - USA: The use of auto-escalation where members sign up in advance to contribution increases based on future salary increases
    - Iceland: Financial Education within schools
    - Sweden: Dreams, an App to set a sum and a date for when you want to achieve a specific project. Targeting a visible investment horizon is more achievable than the very distant horizon of retirement
    - Australia: Strong sense of awareness and ownership of individual superannuation funds. SuperSuper, a shop-and-save program with hundreds of retailers to offer cash rewards (micro savings) that are added to the superannuation pension account
    - UK: Recent auto-enrolment experience and NEST's post retirement investment options
    - Turkey/Poland: Lessons from recent auto-enrolment introduction.
    - Italy: Covip per il cittadino (The national supervisor for citizens) dedicated web site where to find information on the functioning of the pension funds, to compare the costs and the returns, where to find information to simulate the first pillar pension and other relevant information. https://www.covip.it/per-il-cittadino

- Italy: “Legonomia”, a teaching program using Lego bricks to foster financial education by “Fondazione per l’Educazione Finanziaria e al Risparmio”
- Germany: since 2018 so-called "pure DC" (“reine Beitragszusage”) are allowed by the legislator, but only based on collective agreements by employers and trade-unions. But until now no agreement was definitely implemented. Further research should be done on the fundamental reasons of this delay (behavioral biais due to risk aversion e.g.)
- Malta : Few occupational schemes in existence and so many still rely on the State Pension. Government introduced a few years ago an incentive for people to delay taking the State Pension and this offered a percentage increase for every year delayed up to age 65. The percentage increase starts from 5% to a maximum of 23%. State retirement age starts at 61 to 65 depending on the age. Thus, for many, their weekly pension rate would exceed the maximum weekly pension. This of course encourages people to keep on in employment up to age 65. The Maltese Government set up a website called “GEMMA” a word that means saving and this to provide money management information including pensions. https://gemma.gov.mt/