

Decumulation phase – some information and preliminary analysis for the work of OPSG DC sub-group

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Definitions

- * Decumulation or payout phase is the period during which assets accrued in the accumulation phase are paid out to the pension scheme member in a funded scheme
- * Three types of decumulation phases:
 - * Annuities
 - * Phased withdrawals
 - * Lump Sum payments

Lump sum/ PW can be paid out by pension funds or life insurance companies

Risks in decumulation phase

- * Longevity,
- * Solvency and
- * Market risk

- * Insurance company standards needed for providers of annuities
 - * Longevity risk calculations
 - * Solvency guarantees behind promised (more guaranteed) benefit

Previous studies, guidelines and recommendations

- * The OECD Private Pensions Working Party policy recommendations 2008 divided in two areas:
 1. The design of the payout phase of pensions and retirement income, including the issues of providers and promoting annuitisation; and
 2. The role of governments and financial markets in managing risks of the payout phase of pensions and annuities.

OECD June 2012 a Roadmap for the good design of DC

- * “For the payout phase, encourage annuitization as a protection against longevity risk. A certain level of annuitization of balances accumulated in DC pension plans should be set as the default mechanism for the payout phase, unless pay-as-you-go public pensions or the old-age safety net already provide for sufficient regular pension payments. A combination of programmed withdrawals with a deferred life annuity (e.g. starting payments at the age of 85) that offers protection against inflation could be seen as an appropriate default. The demand for annuities could be also promoted by financial education initiatives stressing that they are insurance products designed to protect people from outliving their resources. Lump-sum payments may have to be discouraged as a form of benefit pay-out, except for small DC account balances.”

OECD June 2012 a Roadmap for the good design of DC

- * “Promote the supply of annuities and cost-efficient competition in the annuity market. Different providers, such as public schemes, non-profit occupational plans, and insurance undertakings may provide different arrangements of risk-sharing in the payout phase that may help strengthen benefit adequacy and diversify risks in retirement income. Competition among different providers in the market for individual and group annuities should be promoted to ensure cost-efficient provision for plan members and to help develop the annuity sector as a whole. “

World Bank: Regulation of Payout Options

- * That the degree of annuitisation depends on regulatory or plan restrictions on payout options. If a high degree of annuitisation is a policy objective, the menu of retirement products and payout options must be regulated accordingly.
- * Important to avoid over-annuitisation.
- * Taking into account public pensions. The more from public pensions, the more flexibility in annuitisation.

European Commission

- * 2007 the EC contracted a study to find out the likely impacts on adequacy that a shift to greater funded provision entails
- * Mercer did the study which was published in 2008
- * A detailed description of the situation in each individual Member State.
 - * Legal framework in each Member State
 - * Products
 - * Coverage
 - * Protection
 - * Level of income
 - * Cross border issues
 - * Other methods of converting pension saving at retirement

EC Green and White papers on pensions

- * Green Paper 2010 stated “It is not always clear what differentiates general saving from pensions. This raises the question whether the label 'pension' should not be restricted to a product that has certain features such as security and rules restricting access including a payout design which incorporates a regular stream of payments in retirement.”
- * “moreover, given that the size of the pension in DC schemes can depend on the year in which the pensioner retires, market regulation needs to address the payout phase such as rules on purchasing an annuity (e.g. whether it is mandatory or voluntary, and the timing).”
- * Connected with the possible need to develop a European Code of Good Practice.

EC Green and White papers on pensions 2010 and 2012

* White Paper 2012:

“(14) Working with stakeholders such as the social partners, the pension industry and advisory bodies such as the Pension Forum, the Advisory Committee on equal opportunities between women and men, the Commission will develop a code of good practice for occupational pension schemes (2nd pillar), addressing issues such as better coverage of employee, **the payout phase**, risk-sharing and mitigation, cost-effectiveness and shock absorption.”

OPSG work on decumulation

- * The focus of the subgroup on the Occupational DC will mirror the Occupational Pensions Committee (OPSC) work in:
 - * Current practices, approaches and options available to members at the **payout phases - Decumulation** of IORPs, both DB and DC in the various Member States
- * Aim *“Report on fact finding in respect of practices at the decumulation phase for occupational pensions”*
- * Link to OPSG sub-group Consumer Protection (also covering decumulation)
- * OPSG’s role is to be only technical, not to formulate pension policy

OPSG work on decumulation

- * Possible topics:

- * 1. Hurdles for cross border annuity markets.
- * 2. Other possible annuity providers.
- * 3. Financial literacy and decumulation phase
- * 4. Importance of good default systems for good outcomes.
 - * Governance of default funds is important. In which way does a DC default need to be different from a DB fund?
- * 5. Technical issues in how to organize the annuity market in order to get good annuity pricing.
- * 6. Need for different decumulation products
 - * No single product can address all needs and risks. Different payout methods (can focus on one, few or all of them)
- * 7. Recent payout phase policy reforms in the Member States
- * 8. Others? (Information to scheme members in IORP II proposal).

Orgnisation, Deliverables and timeline

- * Task 4 of the OPSG DC sub-group: _Jan Sebo, Niels Kortleve, Laure Delahousse
- * Presentation to full OPSG a report on DC decumulation phase
- * Q3 2014, 15/10
- * Priority: Medium