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

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BETTER POLICIES FOR BETTER LIVES

YES, IT IS NECESSARY

THE OECD HAS DEVELOPED A ROADMAP FOR THE GOOD DESIGN OF RETIREMENT SAVING PLANS

BETTER POLICIES FOR BETTER LIVES

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

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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

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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

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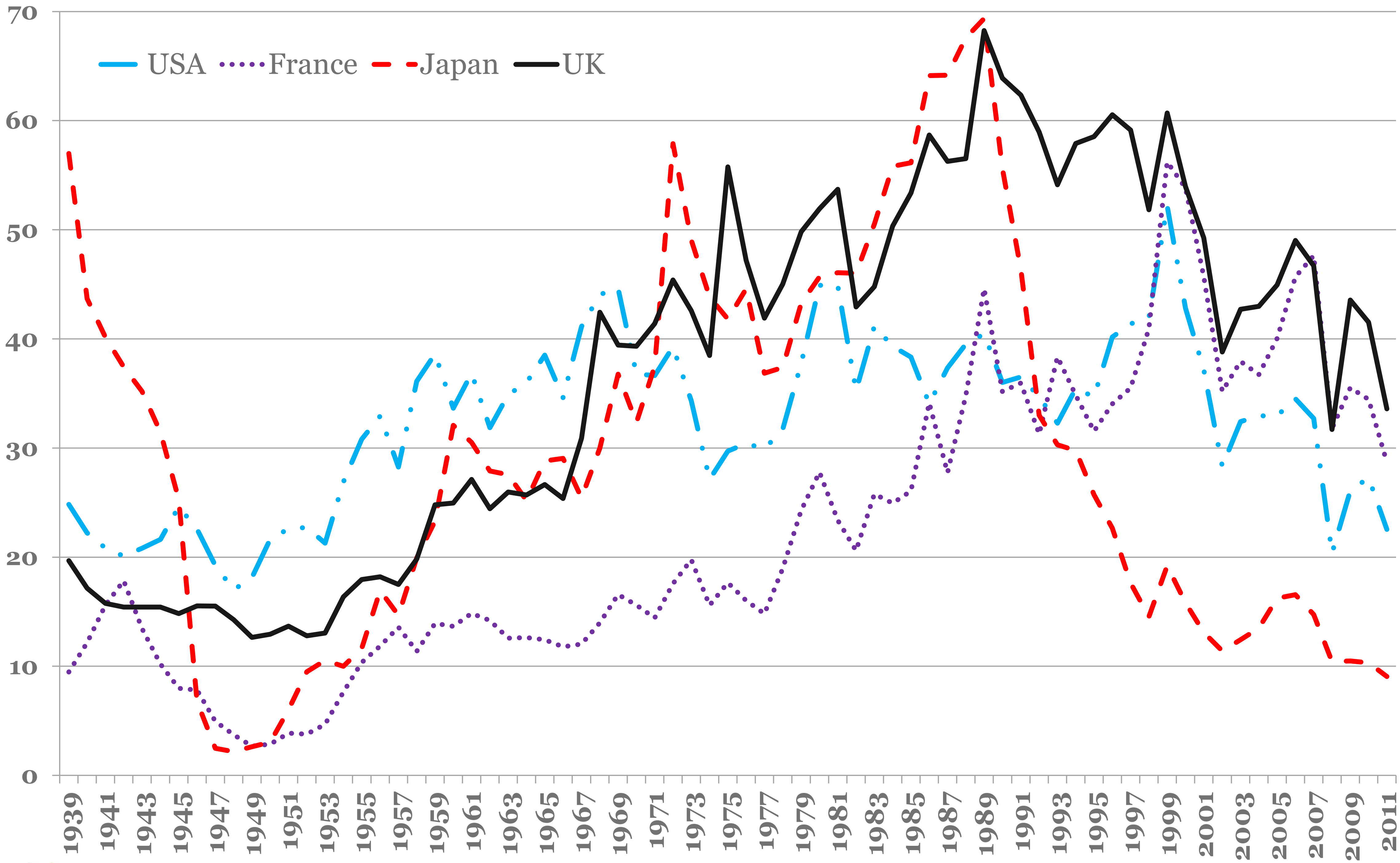
Challenges: large volatility of retirement income in DC plans



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OECD response: Roadmap

- 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

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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

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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

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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

Actions policy makers should take

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

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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

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THANK YOU VERY MUCH

www.oecd.org/insurance/private-pensions

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