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OPSG position paper on EIOPA report on fact finding in respect of practices at the decumulation phase for occupational pensions

About this paper

This paper is a reflection on EIOPAs report on fact finding in respect of practices at the decumulation phase for occupational pensions which was published 27 October 2014. This report covered key issues such as the start of the decumulation phase, information disclosure rules at decumulation, costs and charges levied on pension benefit payments and their disclosure, options available to members at retirement including tax treatment and types of annuities offered to members. OPSG provides comments on each of these issues.

1. Background

The report recognizes two main drivers for EIOPA's project on the decumulation phase:

1) Many Central and East European (CEE) countries need to introduce legislation on annuities in respect of their 1st Pillar bis schemes and would benefit from an investigation on how the decumulation phase of pension arrangements around Europe is regulated and organised.

2) EIOPA's report of 2013 on Good practices on information provision for DC schemes highlighted the need to provide scheme members in DC schemes with clear, understandable and user friendly information about options for drawing their benefits from a pension scheme, such as lump sums, programmed withdrawals, annuities, etc. The disclosure of costs to members and transparency could also be explored together with the options available in different Member States.

Thus the main aim of EIOPA was to study the decumulation issues in relation to DC schemes but in fact it also covers DB schemes. The report covers many different types of pension products/schemes/providers regulated by various EU or national legislation.

The report is based on EIOPA's pension database and a survey conducted by an OPC sub-group. The report covers 30 countries.

The main topics covered are:

- Start of the decumulation phase (circumstances of retirement);
- Information disclosure rules at decumulation;
- Cost and charges levied on pension benefit payments and their disclosure;
- Options available to members at retirement including tax treatment;
- Types of annuities offered to members.

2. Start of the decumulation phase (circumstances of retirement)

There is great variation how supplementary pension may be used for early retirement. If this is possible the reallocation during the pay-out phase will generally be based on an actuarially neutral recalculation. The decumulation starts mostly between the ages of 50 to 70. There is a tendency to define normal retirement age between 60 and 65 and increasingly towards 67. In order to achieve this legislation, incentives and disincentives are used. In half of the surveyed countries there isn't an alignment of supplementary pensionable age to statutory social security i.e. 1st pillar retirement age. In others this link exists and there at least some countries will introduce it. In 1st pillar bis countries this link has existed but may be broken in the future as 1st pillar retirement ages rise.

Starting decumulation earlier is mostly possible in majority of countries. The exceptions are AT, FI, HR, MT, RO and SE. Notably voluntary occupational pension plans offered by IORPs may offer this possibility. An early retirement benefit possibility is offered in more than two thirds (2/3) of countries in case of occupational pension schemes provided by IORPs. It is also common that plan rules stipulate conditions and additional requirements for early retirement benefit. Some provide early retirement benefits in connection with specific financial situations (unemployment, death of spouse or excessive debt). The majority allow early retirement for disability and in case of death before the decumulation phase began usually the beneficiaries will receive benefits, either in the form of a lump sum or an annuity or the conveyance of the accumulated assets.

It is usually possible to delay decumulation, but this may depend on the rules and conditions of the pension scheme as this may impact the benefits. In most countries it is not possible to contribute into the same arrangement from which the payment of an annuity has started in order to increase the amount of that annuity later or to constitute a lump sum. There are some pension schemes in DK, HR, IS, NL, FR, LV, MT and SE where this is allowed. Only some schemes in DK, MT and UK offer delaying the decumulation phase by transforming a part of the accumulated capital into an annuity, while in the same time continue paying contributions to the same arrangement in order to buy additional (separate) annuities from it later.

OPSG comments:

- *Statutory and supplementary retirement ages are increasingly linked. The level flexibility of decumulation can be linked to the level of retirement income from 1st pillar pensions if the policy aim is to provide adequate pensions and alleviate old age poverty.*
- *Starting decumulation earlier or delaying it should remain policy options for countries as well as pension schemes*
- *Innovation and flexibility such as receiving an annuity and contributing for another one should be encouraged and best practices could be shared.*

3. Information disclosure rules at decumulation

The main aim of information disclosure to members approaching or in retirement should be to help members better understand the decumulation phase. There are major differences in what and how information has to be given to scheme members. Usually, but not always special information disclosure rules apply at or sometime before retirement. Others use the same information for all scheme members. The information content as well as how and when it is to be given varies greatly.

OPSG comments:

- *The great diversity of information disclosure practices can be very complicated for the scheme members. Disclosures practices should provide for understandable and concise information and should help scheme members and beneficiaries making informed choices about their retirement provision. Information in order to be able to compare different decumulation options is important and should be developed taking into account scheme specificities. Especially costs and charges of different available options should be better comparable.*
- *Best practices in information disclosure and scheme member education should be shared.*

4. Options available to members at retirement incl. tax treatment

There can be multiple or just one option for scheme members when reaching the decumulation phase. The report lists five main options in the order how commonly used they are:

- Annuity
- Lump sum
- Programmed withdrawal
- Income drawdown
- Other

The design of the options aims usually to balance flexibility and protection from longevity risk. A pension system should protect people from outliving their own income/resources, that is, provisions on the pension decumulation phase should insure individuals against longevity risk. At the same time, the pension system may also provide some flexibility to members when facing unforeseen circumstances (e.g. health care costs), in paying off debt or allowing for an inheritance (to all or to a part of the accumulated assets or rights).

Different annuity types offer various levels of guarantees and may protect against various risks (e.g.: a variable annuity allows individuals to have access to stock markets gains and losses) or cover against a drop in value of money, whereas an annuity with price index indexation protects members from inflation risk. Annuities can be either mandatory or voluntary. According to the report lump sum payments are a possible option in 25 countries and only three countries (NL, NO and SE) do not allow them. Programmed withdrawals are also quite common (12 countries) as well as income drawdowns (14 countries). The details differ between countries and schemes. There are also various and very different combinations of decumulation options. All in all the decumulation phase is extremely diverse and there are also differences in what is the most popular choice if given options. Also the option to choose from the provider of their choice varies greatly. Whether advice is given to scheme members is also very different from country to country. Usually there is no legal requirement to provide advice. Annuities are usually taxed but lump sums often have tax exemptions. Again, there is great diversity in how decumulation i.e. benefits are taxed.

If there is only one retirement option there is of course no default option. But in most countries even with options there is no default option.

Entities that can provide retirement income include insurance undertakings, IORPs, pension funds, special purpose entities or public authorities. In 11 countries only IORPs provide retirement income but in also 11 countries also life insurance companies which is typically a purchased annuity.

OPSG comments:

- *Annuity markets have experienced difficulties (increased longevity and uncertainty about the future, low interest rates) and flexible options are needed*
- *Countries and schemes should have the power to decide options that suit them*
- *The existing diversity does not enable harmonization of different options*
- *Taxation is important but is a Member State competence*
- *Good quality default options are needed. Best practices could be shared*
- *The introduction of options requires high quality information to the scheme participants and when feasible also advice.*

5. Types of annuities

In this part EIOPA looks more in detail to different types of annuities. EIOPA makes a clear policy statement by stating that "a pension system as whole should protect members from spending their resources, that is, a system should ensure protection from longevity risk. This means that member – retiree will not become dependent from the family and/or the state. Lifetime annuity is the only pay out option that provides protection against longevity risk." But it is recognized that there are other options and many different types of annuities may not even be available.

Annuities are long term products, and they can be life-time products. EIOPA states that because of this it is important for retirees to know if the amount of annuity specified at the beginning of the decumulation will remain the same or if it will somehow change. This means that the annuity contract should specify what the pension adjustment will be and under what conditions it will happen. It is also possible that there will be no change in the amount paid out to the retiree (level annuity). Again, the details in this respect vary greatly between the countries and schemes and thus how the level of an annuity changes during the decumulation phase.

OPSG comments:

- *There is need for diversity in the decumulation phase and thus an annuity may not always be the best option for the scheme member.*
- *The role of the supplementary pension in relation to other retirement income in an important factor in deciding about the flexibility.*
- *Scheme members should not be forced into any decumulation option in adverse circumstances.*