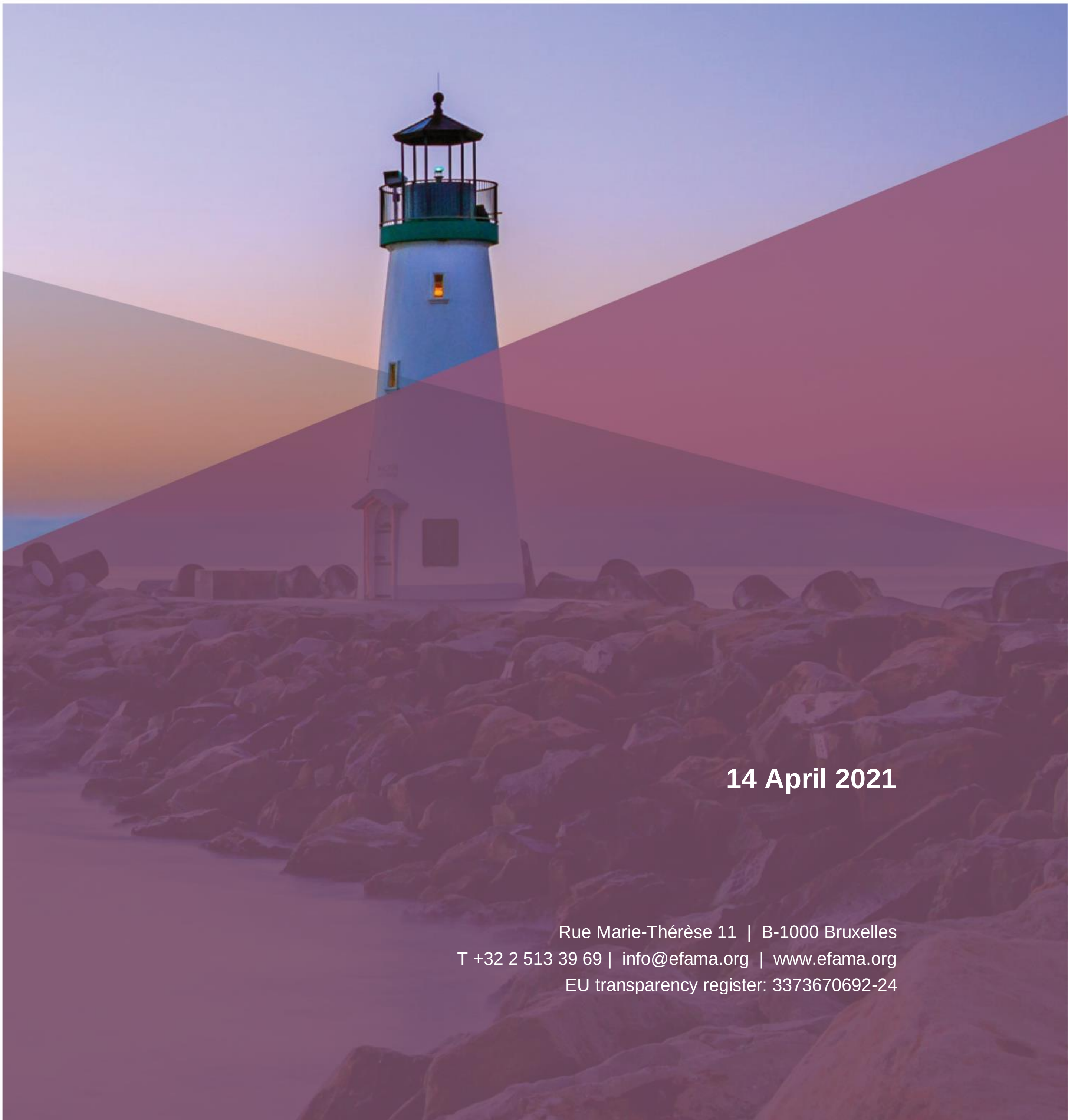
European Fund and Asset Management Association

EFAMA COMMENTS ON THE DRAFT REVISED OECD ROADMAP FOR THE GOOD DESIGN OF DEFINED CONTRIBUTION RETIREMENT SAVINGS PLANS



14 April 2021

Rue Marie-Thérèse 11 | B-1000 Bruxelles
T +32 2 513 39 69 | info@efama.org | www.efama.org
EU transparency register: 3373670692-24

DRAFT REVISED OECD ROADMAP FOR THE GOOD DESIGN OF DEFINED CONTRIBUTION RETIREMENT SAVINGS PLANS

EFAMA, the voice of the European investment management industry, welcomes the proposed revised OECD Roadmap. We would like to congratulate the OECD team working on private pensions for the wide-ranging research projects it undertook over the past years, which provided sound, evidence-based arguments to update the 2012 Roadmap.

We strongly support the main messages of the Roadmap, in particular the importance of

- Ensuring the **coherence** of a DC pension component within a broader pension system.
- Providing **financial incentives** to promote retirement saving and ensure inclusiveness.
- Establishing straightforward, stable and common **tax rules** across retirement saving plans to avoid confusion and maintain the attractiveness of saving for retirement.
- Informing savers about the **cost of guarantees** in terms of expected returns and retirement income.
- Considering **automatic enrolment** to enhance participation in DC plans.
- Limiting **early access to retirement savings** to exceptional circumstances.
- Stressing the role of **contributions and investment returns** in reaching retirement income objectives.
- Fostering **competition** in the DC market and focusing on **value-for-money** rather than cost alone.
- Providing well-designed **default options** such as life cycle investment strategies.
- Recognizing that **annuities** are not necessarily the best protection against longevity risk.
- Providing **flexibility** in the choice of solutions for the pay-out phase.
- Ensuring appropriate **mortality assumptions** are used by providers of lifetime pension income.
- Ensuring effective, personalized, regular, consistent and unbiased **communication** to members.
- Adopting **national financial education strategies** to increase awareness about the importance of retirement saving.

There are, however, a few points on which some clarifications and adjustments would be useful to reinforce the recommendations and avoid misunderstanding.

Proposed message n°3 relating to retirement income objectives

As noted above, we agree on the importance of confirming that total contributions should be sufficiently high to achieve retirement income objectives. It would also be helpful to stress that the earlier people start to save for retirement, the best chance they have to reach a target retirement income. This is the case because ‘time is your friend’ when it comes to long term investments. In fact, for investing, time is more powerful than the amount people invest. The reason for this is the law of compound interest.

Against this background, we suggest the following small change to the proposed message n°3:

> ***3. Ensure total contributions are sufficiently high to achieve retirement income objectives****.* *Automatic and gradual increases to contribution rates can help members to reach appropriate contribution levels over their career. Employer matching contributions can also promote employee*

contributions, while technology can help members to contribute more by simplifying the contribution process and providing access to affordable financial planning. Encouraging members to start saving for retirement early even with small amounts and contribute for longer by postponing retirement improve their chances of reaching their desired retirement income, particularly when life expectancy increases.

Proposed messages n°5 and n°9 relating to cost, value-for-money and net returns

We fully agree that special attention should be given to the cost of pension products. We also welcome the improvement brought to the text by emphasizing the term 'cost-efficient' in addition to 'low-cost'. We are indeed convinced that savers are willing to pay for a service that provides sufficient value. From this perspective, the challenge for DC pension plan providers is not necessarily to offer the lowest cost possible but to ensure that fees fairly and consistently reflect their capability to deliver what savers need. We are pleased to note that the OECD team has integrated the importance of these considerations in its analysis.

It is of course crucial that savers can understand the value of the solutions and services they receive. We agree with the comment made in the preamble of the Roadmap that value-for-money and qualitative features are much more difficult to be measured in objective terms than costs. However, given the importance of these features, we would like to make two suggestions:

- The OECD team on private pensions is ideally placed to undertake a project that would aim at helping providers and stakeholders to measure broad non-financial objectives and services such as consideration of ESG factors and investment advice, which can be offered by DC pension plans.

- We propose to amend the proposed message n°9 in the following way:

  Comparison tools should provide standardised information to allow users to compare performance, costs, and investment allocation, ~~and other plan features~~ as well as information on the qualitative features provided by the plan and the value provided to participants.

In addition, following the same reasoning, while agreeing that cost disclosure is very important, we strongly believe that the Roadmap should also stress the need to inform savers about net returns, for different reasons.

- Many people believe that they do not receive an adequate return on their savings. A key element to address this concern is to give greater importance (than is currently the case) to the net performance and, more broadly, as explained above, to the outcome expected from DC pension plans.

- One of the most tangible benefits of DC pension plans is that they offer higher returns than risk-free assets over the long term. We need to explain that there is an opportunity cost of not saving for retirement, which can have a significant impact on their standard of living in retirement.

- Members should also be informed that inflation impact the outcome of their savings. By way of illustration, assuming a 2% inflation rate, if a saver leaves EUR 10,000 in a bank account offering zero interest rate for 10 years, this money would allow the saver buy something that is worth EUR 8,200 today. This represents a loss of 18% in real terms.

Against this background, we suggest the following other change to the proposed message n°9:

> *Comparison tools should provide standardised information to allow users to compare performance measured as net return after costs and inflation, costs, …*

Finally, we believe that it would be useful to distinguish between the information provided to prospective members from the benefit statement addressed to members in order present them with up-to-date information on key data, such as all the costs and the past performance of their DC pension plans.

Proposed message n°5 relating to pricing regulations

We appreciate that the proposed message does not endorse any specific type of pricing regulation and recognize the need to appropriately design them. Still, we are concerned that the Roadmap suggests that pricing regulations may be needed, notably because this could be interpreted as encouragement to introduce caps on fees. Pricing regulation should be a last resort in the regulatory toolkit, used only where competition does not function effectively to bring down prices and improve quality.

As explained in Chapter 3 of the *OECD Pensions Outlook 2018*, charge caps can have unintended consequences. If the cap is set too high, charges tend to rise to the level of the cap, which quickly became the market price for all similar retirement savings products. A low cap can lead to providers competing on price alone, discouraging pension providers from focusing on the quality of their proposition as well as discouraging innovation in investment design. A low cap may also discourage new entrants, inadvertently making a market less competitive. Establishing the correct level of the cap is especially complicated in markets where providers have different cost structures. Setting the cap in line with the cost structure of large, vertically integrated providers might squeeze out smaller providers.

It is also the case that the total cost of a pension plan is determined by the costs of various activities and services that are often provided by different services providers, e.g., administrator, investment manager, distributor, advisor, custodian, lawyer, etc. Imposing a fee cap requires dividing the fee between these different providers. It is virtually impossible to end up in a situation in which each provider is satisfied with the portion of the fee s/he receives. This has a detrimental effect on the service quality and may lead to the decision to quit the market concerned. Hence, a cap can be too blunt a tool and work against members' interests. The problem becomes intractable when the fee cap covers the provision of individualized advice and is set at too low a level to cover the costs of suitability tests and personalized recommendations. This is likely to happen to the pan-European Personal Pension Product (PEPP) in Europe, which is subject to an all-inclusive 1% fee cap. The type of advice required under the PEPP Regulation – a personalized recommendation, taking into account in particular an individual's accrued retirement entitlements – is simply not economic in a 1% cap that also includes the cost of manufacturing, managing and distributing the product. This situation will prevent most, if not all, potential providers from developing an economically viable business model for the PEPP. Consequently, consumers would not have access to the competitive, value-for-money personal pension market that is the launch of the PEPP aims to create.

Against this background, we suggest the following other change to the proposed message n°5:

> ***Promote low-cost and cost-efficient retirement arrangements in both the accumulation and pay-out phases.*** *It is essential to promote initiatives to foster competition and to improve disclosure, comparability, and transparency. As a last resort ~~T~~they may need to be complemented with appropriately designed pricing regulations and structural solutions that protect members' interests. When pricing regulation is being considered, ~~P~~proper impact assessments should be carried out to examine whether there is a need for such a measure, focusing on its potential consequences on the delivery of high-quality, cost efficient DC plans. Structural solutions should…*

Proposed message n°5 relating to structural solutions

In most countries, the main providers of DC pension plans are occupational pension funds, insurance companies and asset management companies in countries where these institutions are authorized to operate as providers in the DC market. In general, occupational pension funds are first and foremost institutions with a social purpose, which are strongly embedded within national social systems, primarily governed by social and labour law against the background of well-defined institutional and governance frameworks. In addition, pension funds are part of a triangular relationship with the representatives of the employees and the employers, and concentrate on delivering adequate, safe and affordable pensions and retirement provisions for their members and beneficiaries.

Against this background, we have difficulties in understanding why a pension system organized around occupational pension funds would not work effectively and should be replaced by a system organized around "*large industry-wide non-profit providers, and independent centralized provider*".

The preamble of the Roadmap suggests that this type of arrangements may be optimal in small markets with a large number of providers to optimize economies of scale and avoid the emergence of an oligopolistic situation in the DC market. Frankly, we do not believe that moving away from the principle of the market economy to adopt pricing regulations specific to centralized market economies would be a positive thing. What matters in our view is to ensure that that a broad range of providers, including insurance companies and asset management companies, can operate within a level playing field in the DC market to increase competition between providers. This approach supported by the three principles highlighted in the Roadmap – disclosure, comparability and transparency – would give savers more choice and provide them with more competitive products. In addition, the possibility for savers to switch providers regularly is also key to stimulate competition on the market, ultimately resulting in better quality products.

In conclusion, we recommend reconsidering the text of the proposed message relating to structural solutions, in order to provide clearer guidance on the use of structural solutions. We have attempted to amend the text in this direction, drawing on the current message n°4, which provides clear indication on the circumstances in which some structural solutions could be considered.

Structural solutions should have strong institutional and governance frameworks, and can include incentives in place to improve efficiency and reduce costs in the pensions industry such as clear rules for switching providers, appropriate tender mechanisms or default allocation to low-cost providers, especially in auto enrolment systems, and ~~tender mechanisms, allocation of individuals to low-cost providers, cost-efficient consolidations, large industry-wide non-profit providers, and~~ independent centralised providers in compulsory retirement saving systems. ~~Measures to promote cost-efficiency should balance the benefits of fair competition and economies of scale with the risks of an oligopolistic outcome.~~ Finally, fees charged to participants should be aligned with the costs providers incur and the value provided to participants.

Proposed message n°6 on default investment strategies

We fully support the message that a default option is necessary for those unable or unwilling to make a choice and that members should also be able to tailor their investment strategy to their personal circumstances and preferences. It is also important to take into account the longer-term horizon related to retirement savings when assessing the risk appetite/profile from an individual; this is crucial to avoid an advisor setting a too prudent investment allocation missing the ultimate goal of adequate retirement income generation within a DC pension plan. In this context, we believe that DC pension plans should be allowed to invest a portion of their portfolio long-term asset classes (notably illiquid) which are well suited to long-term investment.

Concerning the default option, we believe that the Roadmap's recommendation is incomplete because it refers only to the situation in which the objective of the default is to encourage younger members to take on some investment risk and to protect people close to retirement against extreme negative outcomes.

As explained in the preamble to the Roadmap, there are situations where (i) the objective of the default option could be to maximise pension assets at retirement time, and (ii) the replacement rate from public PAYG and solidarity net sources are deemed adequate for lower income individuals and the DC component is not seen as a major component of the retirement mix. For each of these two situations, the preamble explains that the default investment strategies "*involving a high exposure to higher risk assets may be more appropriate".*

On this basis, we strongly believe that the proposed message n°5 should be more explicit to avoid suggesting that there are situations where the default investment strategy should involve a high exposure to low-risk assets or even capital or investment return guarantees. Opening the door to this kind of interpretation would be very unfortunate because this would not be in line with the findings of the OECD research in this area.

Against this background, we suggest the following other change to the proposed message n°6:

Ensure that all individuals have access to appropriate investment strategies and a well-designed default. *For people unwilling or unable to choose, a default investment strategy should be established in line with the objectives of the DC pension system and the structure of the pay-out phase. In general,~~For example,~~ life cycle investment strategies can be well suited to encourage members to take on more investment risk when young, and to mitigate the impact of extreme negative outcomes when close to retirement. Strategies involving a relatively high* *exposure to higher risk assets may be appropriate in other situations, even when approaching retirement age. For people willing to choose their investment strategy, different investment horizons, ~~and~~ risk profiles, and asset classes should be offered. To assess the appropriateness of different investment strategies against a policy objective, risks affecting DC pensions, such as number of years to retirement, labour, financial, economic, demographic and long-term sustainability risks, should be considered.*

Proposed message n°7 on the payout phase

We agree that pension systems need to provide for sufficient lifetime pension payments. Pay-as-you-go public pensions and/or old age safety net ensure that this is the case in many countries, at least in Europe. In this case, it would be counterproductive to impose the annuitization of assets accumulated in DC pension plan assets, for several reasons.

- Individuals are unhappy about the inability to bequest assets and give up control of their retirement assets. As people may need to access their money in retirement to finance health care costs, it helps to have flexibility in the event of an emergency or extended stay in a long-term care facility.

- People understand that if they die within the first year of buying an annuity the investment return is -100% because all money is lost to the annuity provider, and to the benefit of other investors.

- Annuities are not cheap products as their attractive features, such as lifelong payments, come with a cost. The quality of an annuity depends on the solvency of the insurance company. If the insurance company goes bankrupt, the annuity may go with it.

- Annuity rates move with bond interest rates. This means that in today's low interest rate environment, the monthly annuity payment people can expect is significantly lower than ten years ago.

Altogether, these disadvantages may not be worth buying an annuity in countries where the social protection system provides a lifetime income above the poverty level. In this case, it makes sense to have full flexibility in the payout phase.

We also believe that the role of full lump-sums should be considered alongside state pension provision as well as the wider occupational and personal pension system. In our view, full lump-sum payments should only be discouraged as a form of benefit pay-out if pay-as-you-go public pensions or the old-age safety net do not offer an adequate level of protection against poverty in old age. Indeed, in so far as savings in DC pension plans is done on a voluntary basis, the perspective to have in hand a savings capital at retirement can be a strong incentive for people to save for retirement. Furthermore, the risk that retirees would tend to deplete quickly their accumulated savings should not be overstated. There is indeed lots of evidence that young retirees who have stopped to earn a living, are aware of the need to manage their savings with prudence.

Finally, we would like to stress that an annuity or a collective arrangement providing protection against longevity risk should not be inferred as the only options for a default pay-out arrangement, as they invariably may not produce sufficient income for a retiree because these options are at the lower end of the risk spectrum. Subject to risk appetite, retirees should equally be allowed and encouraged to consider medium/higher risk default packaged investment solutions designed for post-retirement.

Against this background, we suggest the following other change to the proposed message n°7:

> ***Ensure protection against longevity risk in retirement***. *DC pension plans should provide some level of lifetime income as a default for the pay-out phase, unless other pension arrangements already provide for sufficient lifetime pension payments. Lifetime income can be provided by annuities with guaranteed payments for life or by collective arrangements where longevity risk is pooled among participants. The choice of the type of arrangement will depend on the desired balance between the cost of guarantees and the stability of retirement income. Flexibility could be provided by allowing for partial, deferred or delayed lifetime income combined with programmed withdrawals, taking into account the individuals' demands, needs and risk appetite. The role of full lump sum payments should be considered in the wider context of state pension provision and other sources of retirement income and long-term savings. Where DC pension plans are likely to be the main or only source of income in retirement, full lump-sums should be discouraged ~~in general~~, except for low account balances or extreme circumstances.*

Proposed message n°9 on communication to members

We fully agree that effective communication is very important to nudge people to take action to boost their pension adequacy. In this context, it would be worth distinguishing between the personal information that should be given to members of DC pension plans in benefit statements from the generic information that should be given in key information documents to inform prospective members and encourage them to start saving for retirement.

We would also like to note that recent technological innovation and digital investment advisory services offer the possibility to shift from a product approach to a service approach enabling the saver to embark on a proper financial planning approach to prepare his/her retirement.

When stating "*ideally combining all pension sources*", the Roadmap could clarify that this covers both existing occupational/personal retirement schemes but also financial savings (whether short-term or long-term) and/or real estate that could be directed by the investor to cover future retirement needs.

Finally, we note with regret that the Roadmap is pretty silent on sustainability. We strongly believe that it should stress the importance of ESG inclusion within financial offering and reporting embedded in retirement schemes. The Roadmap can be a key tool for directing necessary long-term funding for retirement towards promoting a more sustainable future. Anecdotally one of the most frequent recurring comments on the forthcoming Dutch pensions contract relates to the need to communicate cost-effectively and impactfully with members on how to assess risk and how much they should contribute. As climate and other sustainability risks are investment risks and as many/most OECD Member States are committed to a net-zero economy by 2050 or earlier, the Roadmap can be used to emphasize how good pension design should contribute to sustainable development goals. It's a pretty obvious question for members to ask – will my pension in 2050 be compliant with my country's goals and how is it going to get there?

Against this background, we suggest the following other change to the proposed message n°9:

> ***Ensure effective, personalised, regular, consistent and unbiased communication to members***. *Communication with members should be clear and simple, with minimum jargon, especially when explaining potential options. Personalised information, ideally combining all ~~pension~~ sources of retirement income and other sources of income, can nudge people to take action to boost their pension adequacy, and can be provided through online platforms or pension statements. Projection tools should focus on potential retirement income levels, account for the likelihoods of different outcomes, and convey risks to plan members. Comparison tools should provide standardised information to allow users to compare performance, costs, investment allocation, environmental, social and governance (ESG) factors, and other plan features. Policy makers should ensure that information provided by financial advisors and digital advisory services is accessible, accurate and unbiased. Before concluding a contract, prospective savers should be given all the necessary pre-contractual information in an attractive and clear way to make an informed choice.*

About EFAMA

EFAMA, the voice of the European investment management industry, represents 28 Member Associations, 58 Corporate Members and 24 Associate Members. At the end of 2020, total net assets of European investment funds reached EUR 18.8 trillion. These assets were managed by more than 34,350 UCITS (Undertakings for Collective Investments in Transferable Securities) and almost 29,650 AIFs (Alternative Investment Funds). At the end of June 2020, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 24.9 trillion.

More information available at www.efama.org or follow us on Twitter @EFAMANews or LinkedIn @EFAMA.

Contact

Bernard Delbecque
Senior Director, Economics & Research
bernard.belbecque@efama.org | +32 2 548 26 56