UK auto-enrolment represents 'good progress', but continued focus on DC outcomes essential, says OECD

LONDON 5TH MARCH: Today in many countries defined contribution (DC) pension schemes are expected to provide a major source of retirement income. The latest report from the OECD, released today, has summarised the challenges that policymakers face and recommends key improvements that can help to ensure DC delivers the incomes individuals need.

The OECD argues that pension policyholders and regulators must continue to refine the DC systems if they want individuals to retire on adequate private incomes and avoid further pressure on state benefits. Its analysis evaluates the progress that has been made to date around the world to manage the continuing migration of pensions policy away from public (state) and private employer-sponsored schemes, in which benefits are pre-defined (defined benefit or DB), towards private retirement saving plans, in which benefits depend on the value of accumulated assets (e.g. defined contribution or DC). Key messages for DC development that would improve the adequacy and security of DC retirement incomes include:

- Ensure greater coherence between the accumulation and decumulation phases, and with the overall pension system, including a better focus on the target retirement income, for which all risks affecting saving for retirement (e.g. labour, financial and demographic risks) should be monitored
- Increase contributions, either mandated or through 'nudge' techniques, such as automatic annual increments;
- Encourage people to contribute longer and, for those who are able to do so, to work longer;
- Replace or complement current tax incentives that favour higher earners with matching contributions to make sure that incentives favour lower and median earners as much;
- Complement disclosure-based initiatives to ensure low charges with more effective solutions such as appropriate tender mechanisms or default allocations to low-cost providers;
- Establish default investment strategies, such as life-cycle, that mitigate volatility and the risk of a sudden market shock, such as the 2008 financial crisis, for people close to retirement;
- Encourage annuitisation as a protection against longevity risk. Combining programmed withdrawals and deferred life annuities could be an appropriate default for the pay-out phase;
- Promote the supply of annuities, innovation and cost-efficient competition in the annuity market;

- Develop risk-hedging instruments to facilitate dealing with longevity risk;
- For the long-term success of DC, ensure effective member communication and address financial illiteracy.

Whilst the adoption of the measures outlined above is expected to improve DC outcomes, the OECD said that guarantees, such as a capital guarantee, are also perceived as valuable by members and therefore are likely to improve confidence, prevent opt-outs and encourage higher contributions. However, policyholders and regulators need to consider carefully the potential impact on member cost and the investment return, e.g. when investment strategies become much more conservative to avoid triggering guarantees. They also need to ensure adequate protection from the insolvency of the guarantor.

UK Minister for Pensions Steve Webb said, "We've made great strides with automatic enrolment, but that's just the start; we must ensure that people can access high-quality schemes that are affordable to employers and attractive to employees.

"Too few people have been saving into pensions and part of this is a lack of trust. We need to restore confidence. By reinvigorating workplace pensions, having new defined ambition pensions and ensuring value-for-money charges, we can get more people to put something by for their old age."

Pablo Antolin, Principal economist at the OECD Financial Affair Division, commented, "The OECD recognises the progress that the UK and many other countries around the world have made to develop frameworks that offer sustainable and meaningful incomes for people in retirement. Whilst it is good to recognise this progress it is also critical that further efforts are made to improve the design of DC pension plans in line with the "OECD Roadmap for the Good Design of DC Pension Plans."

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Further information is available at http://www.oecd.org/daf/fin/private-pensions/designingfundedpensionplans.htm