REGULATORY ISSUES IN THE DESIGN OF PENSION ARRANGEMENTS TO MITIGATE LONGEVITY RISK

OECD/IOPS Global Forum on Private Pensions
Designing Pension Systems to Cope with the Ageing Challenge
25-26 October 2018, Beijing
Pension design and regulation

- What are the various types of pension arrangements that address longevity risk?

- What is driving the movement away from providing guarantees?

- What are the regulatory developments behind these trends?
## The risk spectrum of pension arrangements

<table>
<thead>
<tr>
<th>Risks fully transferred to provider</th>
<th>Risks shared between members and provider</th>
<th>Risks shared collectively among members</th>
<th>Risks borne individually by members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional DB</td>
<td>Annuities with minimum guarantees</td>
<td>Collective target benefit schemes</td>
<td>Individual DC</td>
</tr>
<tr>
<td>Traditional annuity products</td>
<td>Hybrid DB</td>
<td>Collective individual DC schemes</td>
<td></td>
</tr>
<tr>
<td>Longevity insurance</td>
<td></td>
<td>Tontine-type schemes</td>
<td></td>
</tr>
</tbody>
</table>
Challenges to offer guarantees and insure longevity risk

- Accounting and valuation requirements
  - Recognition on balance sheet (IFRS/IAS19)
  - Discount rates
  - Solvency vs. going concern

- Capital requirements
  - Longevity is a very long term risk
  - Implications for the cost (and therefore demand)
Funding/solvency regulations can be based on form...

- Regulation specific to type of pension arrangement
- Any institution managing that type of plan is subject to same regulation

...or institution

- Only certain types of institutions allowed to manage certain types of plans
- Different types of institutions can manage same type of plan (but don’t?)
  - Austria, Belgium, Germany (?), Portugal, Spain (?)

But the boundaries are not always so clear

- Different institutions can operate in the same space indirectly
- Insurance companies can insure benefits in occupational DB plans
  - Risk management (UK buy-ins)
  - Standard practice (DB accumulation plans in Kenya)
- New types of arrangements could raise questions
  - Master trusts in UK?
Pension arrangements are moving towards more collectivity and fewer guarantees

- **Israel** – New Pension Funds introduced in 1995
  - DB closed to new members in response to high deficits
- **Netherlands** – Defined Contribution Scheme Act, June 2016
  - Allows variable annuity payments for DC plans
  - Previously removed requirement for guaranteed benefits for DB plans
- **Iceland** – transformed mandatory 2\textsuperscript{nd} pillar, December 2016
  - Removed guarantees and went from DB to collective DC
- **Japan** – introduced risk sharing occupational plans, 2017
  - Existing plans require sponsors to adjust contributions to make up deficit
- **Germany** – Law Strengthening Occupational Pensions, January 2018
  - Allows “Pure DC” plans (but are actually collective plans)
- **UK** – 2015 laws to allow CDC
  - Current consultation on secondary legislation needed to implement CDC
- **Australia** – Comprehensive Income Products for Retirement (CIPR)
  - Ongoing consultation on how funds should offer products for members to mitigate their longevity risk
Collectivity presents new challenges

- Benefit accrual
  - DB-type or DC-type
- Benefit adjustment
  - Indexation, nominal benefits, accrual rates
- Risk sharing mechanism
  - Smoothing
  - Buffer funds
  - Forbearance periods
- Complexity and transparency
  - Strong governance and accountability is crucial
  - Adjustments need to be objective and defined in plan rules
For discussion

- What are the biggest challenges faced for pensions/insurance to offer guarantees and provide longevity insurance?

- Is there an issue with existing regulation and institutional frameworks?

- Is the movement towards fewer guarantees and more collectivity the way forward?