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

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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

- **Risks fully transferred to provider**
  - Traditional DB
  - Traditional annuity products
  - Longevity insurance
- **Risks shared between members and provider**
  - Annuities with minimum guarantees
  - Hybrid DB
- **Risks shared collectively among members**
  - Collective target benefit schemes
  - Collective individual DC schemes
  - Tontine-type schemes
- **Risks borne individually by members**
  - Individual DC

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)

Regulation may create an uneven playing field for providers offering guarantees

- 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 2nd 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?

THANK YOU!

Jessica Mosher, Policy Analyst
Email: jessica.mosher@oecd.org

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