OECD Principles and Guidelines for Occupational Pension Systems

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Key trends affecting pension provision

I. Increased longevity: "pure" DB plans (fixed accrual rates and retirement ages) are not sustainable, you force workers to save too much / retire too early.

II. Increased transparency requirements: implicit pension liabilities subject to greater scrutiny and eventually valued at fair value just like explicit (securitised) debt (IAS 19 for occupational DB plans, SNA moving gradually in a similar direction for public DB plans).

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Implications for pension plan design

I. Adjust retirement ages or/and accrual rates on an actuarial basis ("hybrid" DB plans, e.g. rate of return guarantee underwritten by the state – public plans – or employer – occupational plans, NDCs?), keeping the net implicit debt in check.

II. Move to DC plans, which have no liability for the state or employer. The implicit debt is capped and can even be made explicit (recognition bonds). There can still be guarantees, but these are borne collectively by plan members or by pension providers.

Implications for investment risk sharing in occupational pension plans (pre-retirement)

Name	Investment risk	Bearer of risk
"Pure" DB	Fixed rate of return	Plan sponsor (partly member in some cases)
"Hybrid" DB	Fixed rate of return or min. rate of return guarantee (higher of DB-DC benefit)	Plan sponsor (partly member in some cases)
"Hybrid" DC	Fixed rate of return or min. rate of return guarantee (higher of DB-DC benefit)	Pension fund/mutual insurance (and hence members collectively) or financial institution
"Pure" DC	Market rate of return	Pension fund (and hence members individually)

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What about longevity risk?

I. "Pure" DB plans: depends on whether benefits can be taken as lump-sum or annuities. In "final salary" and "career-average" plans, annuity usually set at entry, so *pre-retirement longevity risk borne by sponsor*. Examples: occupational plans in Germany, Japan, the Netherlands (annuities)

II. "Hybrid" DB plans: depends on whether benefits paid as lump-sums or annuities. Annuity usually calculated at retirement, so *pre-retirement longevity risk borne by member*. E.g. cash balance in the US, new plans in Belgium (lump-sums).

What about longevity risk? (cont.)

III. "Hybrid" DC plans: depends on whether benefits paid as lump-sums or annuities. Annuity rate usually set at entry but can be adjusted for retirees also, so *pre-retirement longevity risk borne collectively by members and beneficiaries*. Examples: Denmark, Iceland, Switzerland

IV. "Pure" DC plans: depends on whether benefits paid as lump-sums or annuities. Annuity calculated at retirement, so *pre-retirement longevity risk borne by member*. Examples: new plans in Latin America and Central-Eastern Europe, Italy, Portugal, Spain

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Recent developments in occupational plans

I. Uneven coverage: only Scandinavian countries and countries that have introduced mandates (Switzerland, Australia) have > 50% coverage.

- Promotion of industry-wide arrangements in Belgium, Germany
- Simplification and low costs in DC arrangements in Ireland, UK, Sweden

II. Transformation/decline of "pure" DB plans: closed to new entrants (UK – active membership of DB is 16% of workforce), transformed into cash balance and DC plans (US), move from final salary to career average plans (Netherlands)

The OECD's role on private pension systems

I. Two basic goals of OECD activities in private pensions:

- Source of comparable, timely, reliable information
- Practical, effective policy advice, especially on regulation, with a view to promote **benefit security**

II. Regulatory/standard-setting work:

- 15 basic principles for the regulation of occupational pension plans and related guidelines developed by the WPPP, endorsed by the INPRS (7 core principles)

The OECD's guidelines for the regulation of occupational pension systems

I. Approved guidelines

- Guidelines on pension fund governance
- Guidelines for the protection of the rights of members and beneficiaries

II. Guidelines in discussion

- Guidelines on funding and benefit security
- Guidelines on investment

The OECD's guidelines for the regulation of occupational pension systems (cont.)

III. Future guidelines

- Guidelines on conditions for effective regulation and supervision
- Guidelines on the establishment of pension plans, pension funds, and pension fund managing companies
- Guidelines on supervision

Each Guideline correspond to one of 7 CP

The OECD's (non-binding) instruments to implement pension principles and guidelines

I. OECD Recommendation on Core Principles of Occupational Pension regulation

- Contains all 7 CP and Guidelines developed by the WPPP
- 30 OECD countries to approve it this week. Two new observers (Brazil and Russia) will be invited to adhere

II. OECD's Occupational Pension Core Principles and Methodology

- Assessment methodology, can be used in World Bank-IMF FSAP (first case, the Netherlands, 2003)

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Considerations for non-OECD countries

I. Creation of new International Organisation of Pension Supervisors (IOPS)

- Focus on pension supervision and regulatory issues related to supervision, including development of supervisory standards
- Partnership agreement with OECD, including joint development of standards where relevant

II. OECD's opening to non-members

- Observer, participant status in OECD WPPP
- Regular events in three main regions (Asia, LA, CEEC)

Underlying criteria for effective pension regulation

- Benefit security as the ultimate goal
- Simplicity in implementation of requirements
- Adaptability to new trends, systems
- Flexibility in emergencies

Benefit security: implications for the regulation of DB plans (occupational)

I. Strict governance requirements

II. Strong funding rules

III. Risk-based premia for guarantee schemes

IV. Priority creditor rights in case of sponsor bankruptcy

V. Dynamic asset-liability management

VI. Vesting and portability of benefits

VII. Indexation requirements

Benefit security: implications for the regulation of DC plans (occupational and personal)

I. Effective regulation of pension funds, other financial providers and financial advisers / salespeople

II. Member fees and cost control

III. Dynamic asset-liability management for the household

IV. Simple, limited investment options

V. Financial education of plan members and beneficiaries

VI. Disclosure to plan members and beneficiaries

Further information on OECD and INPRS work on private pensions

I. www.oecd.org/daf/pensions

II. www.inprs.org