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BETTER POLICIES FOR BETTER LIVES

Major Trends in Pension Reforms

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Disclaimer: The first two sections of this presentation are mainly based on published OECD work. However, the responsibility stays with the author.

1.

Overview of recent pension reforms

(based on OECD Pensions at a Glance 2013)

Overview of pension reform goals in 34 OECD countries, 2009-13

	Coverage	Adequacy	Sustainability	Working Life	Administrative efficiency	Diversification / security	Other
Australia	x	x	x	x	x		x
Austria	x	x	x				x
Belgium				x			
Canada	x		x	x		x	x
Chile	x	x			x	x	x
Czech Republic			x	x		x	
Denmark				x	x		
Estonia		x	x	x	x	x	
Finland	x	x	x	x		x	
France	x	x	x	x			x
Germany		x	x	x			
Greece		x	x	x	x		
Hungary		x	x	x		x	x
Iceland							x
Ireland	x		x	x		x	x
Israel	x	x				x	
Italy		x	x	x	x		
Japan	x	x	x		x		x
Korea	x		x		x		
Luxembourg	x		x	x			
Mexico		x			x	x	
Netherlands						x	
New Zealand		x	x				x
Norway		x	x	x			
Poland	x		x	x		x	
Portugal	x	x	x	x		x	
Slovak Republic			x		x	x	
Slovenia			x	x			
Spain		x	x	x			
Sweden		x	x	x	x	x	
Switzerland			x			x	
Turkey				x		x	x
United Kingdom	x	x	x	x	x	x	x
United States	x	x	x				
NUMBER OF COUNTRIES	**15**	**20**	**26**	**22**	**12**	**17**	**12**

Source: OECD, Pensions at a Glance 2013

Classifying the goals of pension reforms…

Key, «Final» Goals

- Coverage
- Adequacy
- Sustainability/ affordability

«Instrumental» Goals

Broad policies aimed at achieving the final goals

- Longer working lives (raising effective retirement age)
- Administrative (cost) efficiency
- Diversification (across pillars, kinds of schemes, providers, investments) & security

Additional «horizontal» goal:

- Equity across generations, genders and tipes of workers (may imply redistribution)

Key goals and major drives in recent reforms

➢ Most countries addressing multiple goals at the same time

- Sustainability is the most common goal (26/34)
  - Almost all countries in Europe (20/24)
  - Major drives: increases in life expectancy, inherited systems not ready for ageing populations (LT); fiscal consolidation (ST)
- Adequacy is a close second (22/34)
  - major drives: the great crisis and increased risk of poverty for the lower-income elderly (ST); in LT there is a serious trade-off with Sustainability
- Coverage is third
  - counting (14/34) includes reforms aimed at increasing participation in 2°, 3° pillar. In the OECD area, coverage in the 1° pillar is limited to

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2.

Trends and «good practices» in pension policies

Raising the retirement age…

- Raising the effective retirement age is essential for sustainability in all regimes
- in NDC and funded schemes, it also improves adequacy

most relevant implementing measures:

- Raise statutory pensionable age taking into account future increases of life expectancy
  - ➢ Set a LT calendar for further increases
  - ➢ or (better) Index pensionable age to life expectancy (IT, DK…)
- Ban/penalize early retirement and introduce incentives for postponing retirement
  - ➢ in NDC and funded schemes, incentives are built-in and actuarially fair
- Address labour market issues to favour old-age work

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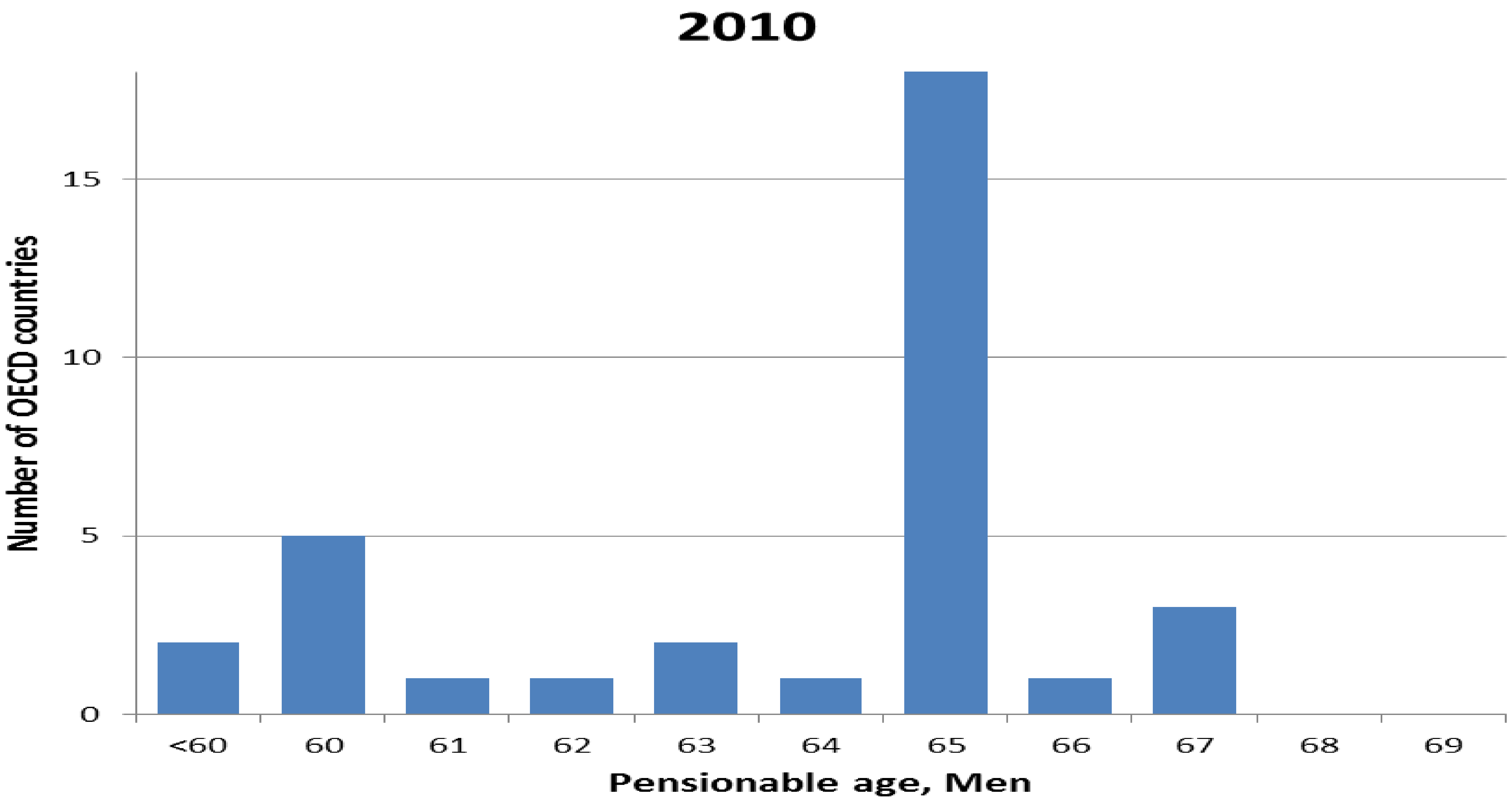
…Raising the retirement age…

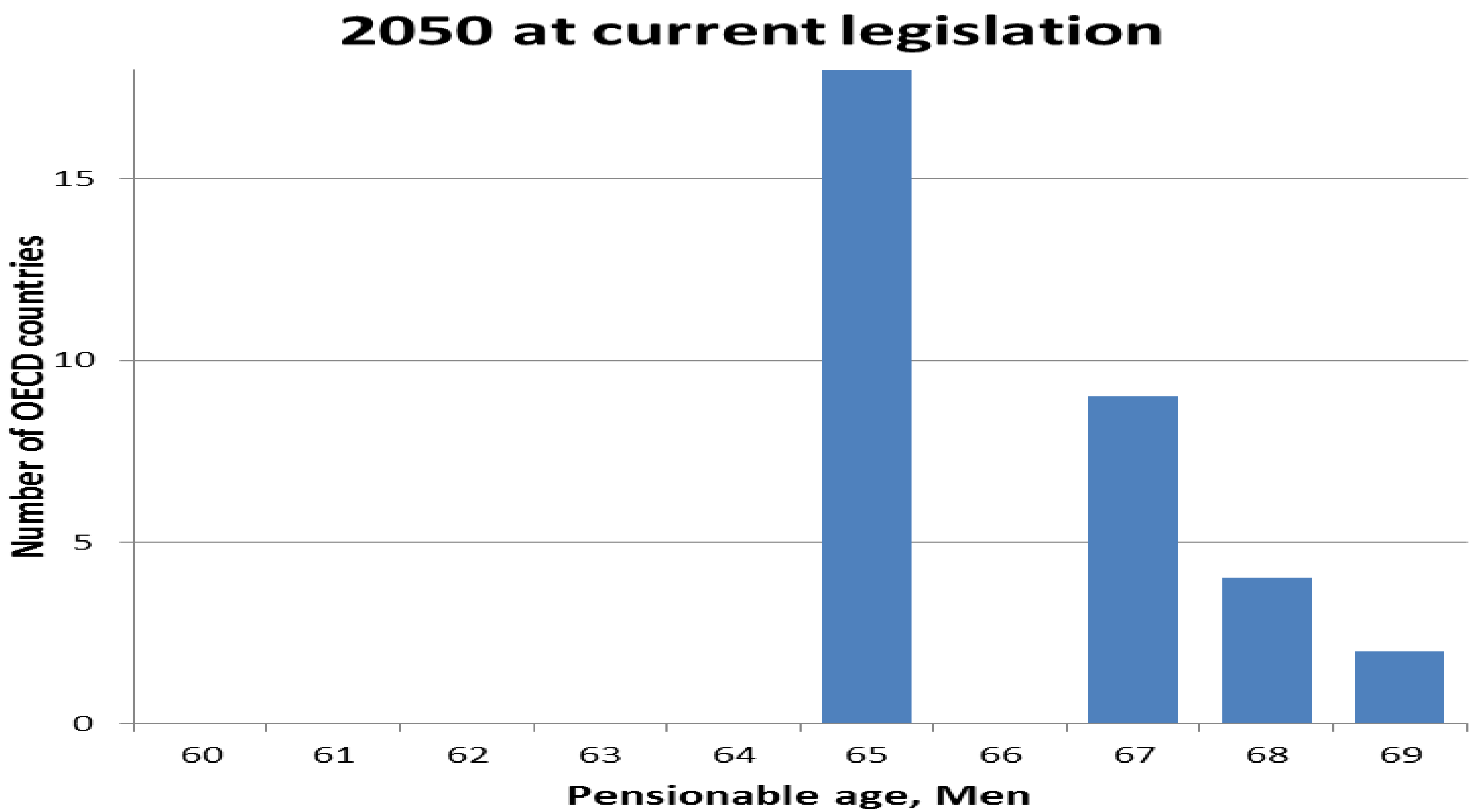
…in 2010 the pensionable age was still below 65 in a number of countries
(for women often was much lower)…



Source: OECD Pensions Outlook 2012

…Raising the retirement age…

…at current legislation, in 2050 a few OECD countries have already set the pensionable age well beyond 65; none is still below; women are mostly aligned to men



Source: OECD Pensions Outlook 2012 and updatings from various sources

Dealing with Adequacy…

- Adequacy has many dimensions; a set of indicators are needed
  - Replacement Rates (RR) at end-career & RR career-average
  - Pensioners close or below absolute & relative poverty levels
  - Information on other sources of income & non-pension wealth
- Trade-off adequacy/sustainability suggests to focus redistribution policies on the groups more at risk of poverty (safety nets)
- Adequacy for the relatively better-off can be left to voluntary savings; however, it is helped by
  - closer correspondence contributions/benefits (e.g. NDC)
  - development of supplementary, funded schemes

NDC: an emerging standard

Since the early 90's a few countries have been transforming their PAYG, earnings-based systems into NDC systems (SWE, ITA, POL, LAT, NOR, RUS)

NDC systems have important desirable properties

- while still PAYG, built-in financial sustainability (if well designed)
- improve LT adequacy when associated with indexing pensionable age to life expectancy
- fairness of relation between contributions and benefits (encourages workers in the informal sector to emerge)
- preserving actuarial fairness, may easily allow individuals to choose when to retire (subject to minimum thresholds)
- redistribution mechanisms are needed (for those with low contribution density), but are more transparent than in traditional PAYG systems

...and few critical aspects

- Transition phase

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Trends and good policies for funded pension schemes

- Introducing nation-wide Auto-enrolment (NZ, IT, UK)
  - a smart middle-way btw. valuntary and mandatory systems, building on behavioural economics
  - implementation is very important for success (and national conditions matter a lot)
  - make «value for money» solutions available for all is a must
  - <u>Defaults</u> play a key role (for contribution rates, investment options…)
- Searching for good risk-sharing arrangements as alternatives to pure DB and DC
  - Defined ambition, conditional benefits, ex-ante and ex-post benefit adjustments
- Trend in favour of DC arrangements is unstoppable: but they have to be designed well (see OECD Roadmap)

The OECD Roadmap for the good design of DC pension plans

1. Design DC pension plans coherently with structure of the pension system
2. Encourage people to contribute and contribute for long periods
3. Improve the design of incentives to Δ contributions and coverage
4. Promote low-cost retirement savings instruments
5. Establish appropriate default inv. strategies while providing choice
6. Favour life-cycle (LC) investment strategies as defaults
7. Encourage annuitization as a protection against LR
8. Promote the supply of annuitites
9. Make it easier to deal with Longevity Risk
10. Ensure effective communication and address financial literacy

This Roadmap was approved by the OECD Woking party on Private pensions in June 2012. For a full copy see

http://www.oecd.org/daf/fin/private-pensions/50582753.pdf

3.

Challenges ahead

Many challenges ahead

- Trade-off sustainability/adequacy will always be there. Set reasonable targets, focus redistribution policies on those in need
- Increase coverage in the self-employed and the informal sector
- Develop labour market policies apt to favouring longer working lives
- Encourage multipillar systems, despite low-growth and fiscal consolidation
- For funded, private schemes:
  - Take the responsibility to nudge people (auto-enrolment, default options)
  - Ensure true consumer protection focusing on low costs & value for money with attention to «industrial organization» of demand, supply, distribution
  - Favour asset allocation with a LT perspective, consistent with the time horizon available
  - Organize the payout phase promoting cost-efficient annuities
- Communicate & educate

→ Let me pick up one challenge, particularly relevant in the EU

EU: encouraging multipillar pension systems in a low-growth context and under the rules of SGP

- Multipillar pension systems are highly recommended by all leading international institutions (including the EC, see the «white paper» on pensions, Feb. 2012)

  →In principle, additional savings to be invested in funded pension schemes would be the easiest way to go. ....but...

- in many EU countries, years of low growth and fiscal consolidation are reducing households' disposable income

  → additional voluntary savings for retirement purposes are difficult to afford or even irrational (as current consumption may be preferable)

- in some countries, mandatory contributions to PAYG schemes may exceed the «optimal» savings for retirement (current debate in the NL suggests a 1/5-4/5 rule; IT has PAYG contributions at 33%)

  →PAYG schemes crowd-out funded schemes

  →in order to strenghten a multipillar structure, opting-out contributions from PAYG to funded schemes would be needed

...but...

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EU: encouraging multipillar pension systems in a low-growth context and under the rules of SGP

……the implementing rules of the Stability and Growth Pact (SGP) are a strong obstacle to diversify pension systems away from PAYG schemes: every euro of pension contributions moved from PAYG to funded schemes increases by one euro the budget deficit relevant for the SGP

→ This rule has contributed to reform reversals in EEC countries, and prevents other countries to allocate significant resources to funded pillars

→ Need to reconsider the rationale for this rule

In a LT perspective, move of contributions from PAYG to funded pillar <u>should be neutral in terms of public budget equilibrium</u>, if it implies a <u>proportional reduction of benefits from PAYG schemes</u> (as in NDC plans)

References

OECD Publications on Pensions

- Pensions at a Glance 2013
- Pensions Outlook 2012
- Pensions Market in Focus 2013
- OECD roadmap for the good design of defined contribution pension plans

http://www.oecd.org/els/social/pensions

http://www.oecd.org/daf/pensions

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Thank you

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