DESIGN AND DELIVERY OF PENSION BENEFITS PENSION REGULATION

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The background

- OECD provides a forum for policy makers, and regulators and supervisors to share experiences and learnt from each other
- This is channel through OECD Committees
- OECD Committee on Insurance and Pensions (IPPC): pension and insurance regulators and supervisors share and discuss experiences on how they address the different challenges they face
- Focus on all pension arrangements where contributions / savings are invested in capital markets, earn a return, and when people retires the assets accumulated will finance pension benefits

Background

- These discussion have led to two main OECD legal instruments on pensions that draw on how countries have improved their asset-backed pensions:
- Strong regulatory framework that makes sure the system works in the best interest of members
  - OECD Core Principles of Private Pension Regulation
- Design the system according to international good practices
  - OECD Recommendation for the Good Design of DC Pension Plans

What is the purpose of the Rec Good Design?

- Provide guidance based on country experiences on how best to design DC pension plans
  - Coherence (external, internal, importance objective)
  - Inclusiveness
  - Contributions align with objectives
  - Cost-efficiency
  - Incentives
  - Investment (options, risk profile, defaults)
  - Managing longevity risk (uptodate mortality tables, projections, regularly)
  - Structure of the pay-out
  - Communication (general, specific, purpose)
  - Financial literacy

What is the purpose of the CP?

- OECD message: pension funds and pension providers should
  - manage retirement savings in the best interest of members and beneficiaries
  - invest in sustainable investments, environmental, social, governance (ESG) opportunities, and to support the economy as long a strong regulatory framework is in place
- The CP are guidelines distilled from the experiences of the different countries to assist countries in having a robust regulatory framework
- There is not one way to do things (one-size fits all).
- There are different goals and different approaches to achieve them

How the CP PPR and R GD evolve?

- The CP evolve over time as pension systems continue to develop and new challenges come along
  - shift from DB to DC
  - Publicly sponsored pension plans (assets managed privately)
  - Diversification => investment regulation: avoid too much country risk (but support the economy), private equity, infrastructure, illiquids
  - ESG, sustainable investment,
  - Isolated from undue political influence, conflict of interest
  - Risk management
  - digitalization, cyber risk, cyber-insurance
- The process of sharing experiences on dealing with new challenges leads to new lessons that the CP and RGD incorporate after discussion and approval by member countries.
- Based on real experiences in different countries

Issues becoming relevant

- Complementary asset-backed pensions work best interest of member
  - best retirement income outcomes: real long-term returns net of fees adjusted by risk and taking into account the overall pension system
  - Diversification (no too much concentration): government bonds?; invest domestically (yes, but strong regulation, appropriate investment vehicles for SMS pension funds)
  - Private equity; infrastructure; illiquid investment (j-curve); ESG; hedging (yes, but avoid speculative): yes, but understand what you are investing in, necessary strong regulation, appropriate investment vehicles SMS pension funds
- Regulation - Change limits to allow investing in alternatives
  - If you do not understand do not invest.
  - SMS pension funds (investment teams)
- Communication: volatility, higher potential retirement incomes
  - OECD Recommendation for the Good Design of DC Pension Plans

Challenges: Incorporating ESG, sustainable investment

- Use assets earmarked for retirement to support ESG (energy transition), sustainable investment, and support domestic economies

Use of assets earmarked for retirement to support the economy

- Yes, of course, retirement savings should be use to invest in support of the economy, investing in sustainable and ESG investment opportunities
- But, only if
  - There are appropriate market structures and financing instruments
  - Suitable investment opportunities
  - Safeguards so providers act in the best interest of members (strong regulatory framework)
- It is essential that pension providers have available appropriate investment vehicles to channel their investments (PPP, infrastructure, Bonds, SMEs)

Strong regulatory framework (OECD)

- Manage the system and savings (assets) in the best interest of individuals, which it is to reach a target retirement income and to invest to get the best return adjusted by risk and net of fees and charges
- Good governance: corporate governance of pension funds (governing bodies) and of any other institution of the complementary pension system
  - Independence from undue political influence / political cycle
  - Diversified: worker, company, and independent representatives. Gender and other factors
  - Corporate governance (board) with capacities appropriate to the function and objectives (individual, collective)
  - Avoid conflicts of interest
  - Clear investment policies aligned with the main objectives, as well as adequate risk management processes
- Strong supervision, sanctioning power, licenses with non-exclusive criteria for all (they can be revoked and new ones can be issued)

Update the Core Principles to reflect new realities and developments

- Scope: all but PAYG pension plans, private and publicly managed pension funds
  - Publicly sponsored pension funds (e.g. Denmark, AP7 Sweden, public sponsored occupational plans in Spain)
  - Reserve funds (Canada, Japan, Korea)
- New realities and developments
  - Sustainability (ESG)
  - Digitalisation
  - Macro factors (external shocks: interest rates, inflation, …)
  - Role of pension funds in the broad context of investment, domestic, growth
  - Incorporate references to IOPS guidelines (RBS, projections, ESG)
- Principle on supervision (CP 6) – in line with the IOPS supervisory principles

Structure of the CP Pension Regulation

- Introductory text: scope. Countries can apply them flexibly given their pension system structure
- CP 1. Conditions for effective regulation
  - Well defined objective on coverage, adequacy, security efficiency and sustainability
  - Well-functioning K mkts. Openness of financial mkts
  - Cost-efficiency
  - Dynamic and flexible: adjust and improve
  - Providers undue political influence

Structure of the CP Pension Regulation

- CP 2. Establishment pension plans, pension funds, and pension entities
  - Transparent and coherent set of legal, accounting, technical, financial, managerial and governance requirements, without imposing excessive administrative burden
  - Legal separation of assets and management entities, and of management entities and sponsors
  - Clear ownership structure
- CP 3. Governance
  - Best interest of members and beneficiaries: real long-term returns net of fees adjusted by risk and taking into account the overall pension system
  - Appropriate division of operational and oversight responsibilities
  - Fit and proper – members
  - Investment strategy – long-term purpose, liabilities, ESG and sustainabili

Structure of the CP Pension Regulation

- CP 4. Investment and risk management
  - Investments aligned with attributes and liabilities
  - Investment regulations consideration principles related to risk diversification and dispersion and asset-liability management.
  - Act in line with the investment horizon and risk-return objectives of the plan, long-term nature of saving for retirement
  - Account ESG factors into the investment and risk management processes
  - Consider carefully quantitative requirements and prudent-person principles
  - Increased reliance on modern and effective risk management techniques using new digital technologies
- CP 5. Plan design, pension benefits, disclosure, and redress

CP 6 - Supervision

- Supervision should promote stability, sustainability, security, long-term investment and good governance to protect the interests of plan members and beneficiaries
- Effective supervision must be set up and focus on licencing, legal compliance, financial soundness and control, minimum capital requirements, investment activity, good governance and integrity, actuarial examination, member communication and redress mechanisms
- SA properly and adequately staffed and funded, to conduct when relevant off and on-site supervision
- SA should have operational independence and be endowed with appropriate and necessary regulatory and supervisory powers, including powers over the functions that are outsourced.
- SA should adopt a risk-based approach to use their resources efficiently.

Structure of the CP Pension Regulation

Occupational Plans

- CP 7. Occupational pension plan liabilities, funding rules, winding up, and insurance

- CP 8. Access, vesting, and portability of occupational pension plans

Structure of the CP Pension Regulation

Personal Plans

- CP 9. Funding of personal pension plans, wind-up and insolvency
- CP 10. Equal treatment, business conduct, competition and portability of personal pension plans

Conclusion

- The design and delivery of pension benefits requires
- Strong regulatory framework that makes sure the system works in the best interest of members
- Design the system according to international good practices
- The OECD provides a forum for countries to share their experiences and learn from each other. This process and the related discussion have led to two OECD legal instruments on pensions that we believe provide options for countries to improve their asset-backed pensions and improve the well-being of their citizens
  - OECD Core Principles of Private Pension Regulation
  - OECD Recommendation for the Good Design of DC Pension Plans

THANKS
Questions?

OECD work on pensions
www.oecd.org/insurance/private-pensions

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