JOINT INSURANCE AND PENSIONS ROUNDTABLE ON RESPONDING TO FINANCIAL PROTECTION GAPS

Summary

On 6 December 2023, the OECD's Insurance and Private Pensions Committee (IPPC) and Working Party on Private Pensions (WPPP) organised a **joint insurance and pensions roundtable on responding to financial protection gaps.** In addition to the IPPC and WPPP delegates, the roundtable gathered key stakeholders from international organisations, national governments and the insurance sector to **discuss common challenges that create financial vulnerabilities** in retirement and in the aftermath of disaster events. The joint roundtable built on discussions at the OECD High-Level Roundtable on Financial Protection Gaps for Disaster Risks held in December 2022, with a particular focus on sharing lessons and best practices between the insurance and pension communities.

Financial protection gaps in retirement savings and for disaster risks pose **significant threats to financial well-being.** Inadequate retirement savings and uninsured disaster losses have **implications for public finances, financial stability and economic growth.** For example, uninsured disaster losses could lead to defaults on loans and mortgages and demands for taxpayer funds to compensate for losses and support economic recovery. A changing climate – along with continued development in high-risk areas - has led to significant increases in losses from climate-related disasters. Increasing longevity and declining fertility rates are creating risks for public pensions and increasing the level of private savings required to meet spending needs in retirement. Inflation and the cost-of-living crisis are making it more difficult for individuals to save for retirement and acquire adequate insurance coverage against disaster risks.

> *Retirees today are facing a perfect storm – they will need to finance longer lives with higher health care-related expenses (such as long-term care) with less pension income and substantially less family support - Bonnie-Jeanne MacDonald, Director of Financial Security Research, National Institute on Ageing, Toronto Metropolitan University*

> *Concerns about the frequency and severity of weather events, rising reinsurance costs and inflationary pressures are making property insurance availability and affordability more challenging -* Eric Dunning, Director of Insurance, Nebraska (United States)

There was significant progress in 2023 in raising awareness of the magnitude and importance of financial protection gaps and in developing guidance and recommendations on how to address these gaps. The Global Federation of Insurance Associations (GFIA) published an **assessment of natural hazard, cyber, pensions and health protection gaps** in March along with recommendations on reducing those gaps. The International Association of Insurance Supervisors (IAIS) released a report in November outlining **the role of insurance supervisors in responding to protection gaps** linked to natural hazards and identifying five areas of supervisory activity that can contribute to addressing these gaps. The OECD Council adopted an updated *Recommendation on Building Financial Resilience to Disaster Risks* aimed at helping governments manage the financial impacts of disaster risks, including by supporting the availability and take-up of financial protection against disaster risks. The OECD is also developing implementing guidelines for the *Recommendation for the Good Design of Defined Contribution Pension Plans*, which will include, in particular, best practices to design inclusive pension systems.

Participants identified a number of common challenges in addressing financial protection gaps in pensions and insurance for disaster risks – related to access, participation, inclusiveness and adequacy of retirement savings and insurance coverage. The voluntary nature of many types of savings and insurance coverage means that a lack of awareness of - or interest in - the need for financial protection and planning can lead to suboptimal decisions.

In the case of insurance, this may be exacerbated by a misperception (overestimation) of the cost of coverage and/or the scope of coverage (i.e., they may not know they are uninsured). Among some segments of the population, there may also be a **lack of trust** in insurance companies and/or asset managers that inhibits people from seeking professional financial advice on retirement savings or acquiring insurance coverage for disaster risks.

> *Retirees often wished they would have started saving at an earlier age, but when you encourage young people to participate in retirement planning events, they do not want to come* - Laura Keddie, Business Manager to Chief Marketing Officer, Standard Life

> *There may be a lack of trust in the financial sector based on previous experiences – for example, such as where people have had an insurance contract that they thought would cover the losses but in fact did not* - Marie Scholer, Senior Policy Expert, European Insurance and Occupational Pensions Authority (EIOPA)

Moral hazard – particularly the assumption that governments will intervene to compensate for shortfalls in financial protection or retirement savings – can also be an impediment to ensuring sufficient insurance coverage and retirement savings.

Behavioural biases such as **availability heuristics, choice paralysis and risk aversion** have an important impact on individuals' propensity to make good decisions for ensuring adequate financial protection.
Availability heuristics can lead individuals to underestimate or undervalue the risks of infrequent events (in the absence of recent experience).

Choice paralysis can impede individuals' ability to make optimal (or sometimes any) decision on participating in a pension scheme, choosing an appropriate investment strategy or acquiring an insurance coverage – particularly when enrollment processes or products are complex and/or involve many choices.

Risk aversion has a significant impact on investment decisions in retirement savings that can lead to lower investment returns and substantial reductions in the level of income available in retirement – as well as a reluctance to leverage alternative sources of income such as home equity.

> *Asking individuals to manage and drawdown that [retirement savings] money is an impossible task – we're basically asking people to manage a pot of money that will change in an unknown way to cover unknown expenses that will change in unknown ways over an unknown time horizon because we just don't know how long people are going to live* - Bonnie-Jeanne MacDonald, Director of Financial Security Research, National Institute on Ageing, Toronto Metropolitan University

> *Behavioural sciences studies have shown that, where individuals uncover more options, they are more likely to make a suboptimal decision, highlighting the risk of obfuscation or choice overload* - Aisling Bradfield, Head of Behavioural Science, SCOR

Technology and innovation – **including financial product innovation** – can play an important role in closing financial protection gaps. Technology can help improve consumer engagement and awareness - and simplify financial protection decisions. In the context of retirement savings, **pension dashboards** that provide individuals with comprehensive information on their sources of retirement savings and income can support better decisions on savings, spending and investment – an approach that could potentially be replicated in the context of disaster insurance. The use of simpler products with easily-understandable triggers (such as parametric insurance) could simplify decisions about insurance purchase.

Product innovation is also providing individuals with **new approaches to managing longevity risk,** such as through the use of dynamic pensions (also referred to as self-annuitisation or variable payout life annuities) that provide individuals with an opportunity to pool their savings at retirement and therefore **mutualise their longevity and investment experience.** This approach can deliver higher investment income and longevity protection by regularly adjusting payouts to account for divergences in investment returns or mortality (relative to initial assumptions).

The **policy and regulatory framework** plays a critical role in responding to financial protection gaps. Regulators and supervisors can impose requirements on insurance companies and/or pension providers to offer products and guidance that meets the needs of consumers and provides clarity on the level of protection provided.

For example, in Australia, the government has implemented a "retirement income covenant" that requires the trustees of superannuation funds to develop retirement income strategies for their members and offer "comprehensive income products for retirement" to help their members choose a retirement income product that meets their needs.

> *Superannuation funds should have an obligation to deliver a certain range of products, a certain level of communication and a certain level of assistance to their beneficiaries – too many won't do it if it's not required* - Nick Sherry, Chair, TWUSUPER (Australia)

> *In the United Kingdom, we have auto-enrolment which has certainly reduced protection gaps but it's still not giving us the coverage that we need...not enough people are covered by these saving plans and those that are don't save enough* - Charles Cowling, President-Elect, International Actuarial Association and Chief Actuary, Mercer (UK)

Regulators and supervisors can also support consumer awareness directly. In the United States, the National Association of Insurance Commissioners (NAIC) has developed consumer awareness campaigns on natural hazard risks and actions that consumers can take to reduce their risk of loss. Increasing efforts have been – and should be – made by insurance and pension regulators to ensure that these messages are appropriately tailored to reach (and impact) different segments of the population.

Default options and various forms of compulsion have been used – particularly in pension regulation - to overcome some of the challenges related to financial literacy and behavioural biases. Auto-enrolment, auto-escalation and default investment strategies can be critical for encouraging participation and enhancing contribution rates and investment returns. Mandatory participation and prescribed contribution rates have also been imposed in some jurisdictions.

The design of these interventions is critical as they can have unintended consequences. For example, auto-enrolment and default contribution rates in private pensions might lead individuals to assume that their automatic contributions will provide sufficient income in retirement and discourage additional voluntary savings.

A sub-optimal default investment strategy could lead to **an imbalance between risk and investment horizon**. For example, one study estimated that as many as 50% of Slovakians may have missed out on an equity market rebound after a default investment strategy focused on bonds was introduced (although risk aversion might have driven some to the bond strategy even if it were not the default).

Addressing NatCat protection gaps is a very challenging issue for supervisors who need to strike the right balance between the prudential perspective and the role of insurance in supporting societal resilience - Shigeru Ariizumi, Vice Minister for International Affairs, Financial Services Agency (Japan) and Chair, IAIS Executive Committee

Regulators and supervisors often need to manage the **potential for conflicts between prudential objectives and supporting the societal role of insurance and pensions** in addressing financial protection gaps (as seen, for example, in the elimination of guarantees in unit-linked savings products which shifts risk to consumers).

A sound regulatory and supervisory framework (potentially complemented by policyholder protection schemes and/or guarantee funds) that protects consumers against misconduct and non-payment is critical in **building trust in insurance and pension systems.**

Other policy, legislative and regulatory areas can also have implications for the ability of insurance companies and pension providers to address financial protection gaps. For example, privacy protection legislation can impact the collection and use of data that might have benefits in terms of expanding coverage or developing products that better meet consumer needs.

In the context of disaster-related financial protection gaps, government policies related to land-use planning and building codes – along with policies related to post-disaster financial support – have important implications for the availability, affordability and take-up of insurance coverage.

Addressing financial protection gaps will require **collaboration between governments, insurance and pension regulators and supervisors and private sector providers of insurance and retirement savings and income solutions.**

The growing debate about "right to be forgotten" could make coverage for critical illnesses challenging due to a lack of the data that had allowed the insurance sector to offer coverage for a number of critical illnesses - Michaela Koller, Secretary-General, Global Federation of Insurance Associations (GFIA) and Director General, Insurance Europe

One of our key findings – a universal finding from our colleagues around the world - is that we need to prevent these events from happening, we need to become more resilient - Christian Pierotti, Chair, Global Federation of Insurance Associations Climate Risks Working Group and Director of Europe and International Public Affairs, France Assureurs

There are significant disparities – that reflect a legacy of systemic discrimination - in who has retirement savings and who doesn't – and who has savings and who doesn't – which can lead to even more stark disparities by the time they reach retirement - Ali Khawar, Principal Deputy Assistant Secretary, Employee Benefits Security Administration (EBSA), Department of Labor (United States)

I like to describe insurance as being able to do three main things for society: prevent, protect – and if those don't work – provoke the requisite policy changes - Michel M. Liès, Chair, Zurich Insurance Group

The role of governments, regulators and supervisors is to provide a framework that encourages individuals to make responsible decisions in support of their financial well-being and ensure transparency and fairness in the operation of regulated financial sector providers.

The role of insurance and pension providers is to design insurance and retirement savings and income products that meet consumer needs and encourage risk reduction. The public and private sectors have complementary capacities and expertise to bring to this effort. As a result, there is **significant scope for public-private collaboration in addressing protection gaps** through building awareness and financial literacy and, in a number of cases, sharing the financial risks through catastrophe risk insurance programmes.

There is a moral component – an obligation to look after citizens – that creates a reputational risk for government if a generation is retiring in poverty – government doesn't look great in that situation - Ali Khawar, Principal Deputy Assistant Secretary, Employee Benefits Security Administration (EBSA), Department of Labor (United States)

There is an increasing **focus on identifying and addressing financial protection gaps,** including among vulnerable segments of the population that have **limited capacity to save for retirement or acquire insurance coverage.**

For example, in the context of insurance for disaster risks, EIOPA has invested in the development of a dashboard on insurance protection gaps for natural catastrophes while the NAIC is preparing to launch a data collection exercise to assess availability and affordability challenges in insurance for natural hazards.

Ultimately, the continued existence of significant protection gaps in disaster insurance, retirement savings and other areas will pose a **reputational risk** for insurance and private pension providers as well as for the policymakers, regulators and supervisors with responsibility for insurance and pension systems.

It's a strong reputational issue for the industry - our job in the insurance sector is risk management and to provide protection to the general public – if there is a growing sentiment that protection gaps are widening – the calls to the insurance sector will become louder - Michaela Koller, Secretary-General, Global Federation of Insurance Associations (GFIA) and Director General, Insurance Europe

Closing the protection gap is the big 'S' in ESG – to this effect, the OECD initiative to build bridges among relevant public and private stakeholders is extremely valuable - Michel M. Liès, Chair, Insurance Development Forum

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