HIGHLIGHTS

OECD Pensions Outlook 2020

OECD

CHAPTER 1

Ensuring a balanced trade-off between the short-term and long-term consequences of policy responses to COVID-19

CHAPTER 2

Determining and assessing the adequacy of retirement income

CHAPTER 3

Funded pension arrangements that can support individuals in non-standard forms of work to save for retirement

CHAPTER 4

Selecting default investment strategies

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Addressing the potential negative consequences of the frequent switching of investment strategies

CHAPTER 6

Retirement income arrangements that share both the investment and longevity risks among different stakeholders sustainably

CHAPTER 7

How governments can communicate in a way that helps people to choose their optimal investment strategies

Governments need to improve the sustainability and resilience of retirement savings systems

COVID-19 has dealt an unprecedented shock to the labour markets and pension arrangements across the world. Policy makers have acted swiftly to address many of the ensuing challenges. Many countries have extended job retention schemes and unemployment benefits, allowing workers to keep accruing entitlements in public pension schemes and, to some extent, in retirement savings arrangements. Similarly, governments took a range of regulatory measures to ensure the sustainability of retirement savings arrangements, such as flexibility around recovery plans, as well as communication campaigns to encourage people to maintain their investments in retirement portfolios to avoid selling and materialising value losses, and to raise awareness of scams, which COVID-19 may have exacerbated.

Even before the outbreak of the pandemic, retirement savings and old-age pension systems were facing significant challenges. Population ageing, with longer lives to finance in retirement and smaller cohorts entering the labour market, as well as a low economic and wage growth environment, low returns in traditional asset classes and low interest rates, were already weighing heavily on funded and pay-as-you-go, defined benefit and defined contribution, and private and public retirement provisions.

COVID-19 compounds some of these challenges and adds new ones. In addition to the likelihood that economic growth, interest rates and returns will remain low long into the future, the health and economic crisis is increasing the risk that people may be unable to save enough for retirement. Supporting retirement income promises in the current context will add pressure on public finances already strained by demographic changes. Operational disruptions because of working remotely, cyber-attacks, frauds and scams, and calls on assets earmarked for retirement to support the economic recovery are all additional issues to be addressed. Moreover, well-intentioned measures to provide short-term relief by granting people access to their retirement savings before they reach retirement age are likely have a detrimental effect on future retirement incomes, particularly where access is granted widely and unconditionally.

Retirement savings arrangements could be more resilient and address the challenges posed by the need of early withdrawals brought about by COVID-19, if long-term savings arrangements include both a savings account earmarked for retirement and a savings account for emergencies.

The sustainability and resilience of retirement savings arrangements depend largely on their role in complementing retirement income and its adequacy. Assessing their complementary role for adequacy requires a clear framework that would benefit from an open and transparent discussion on the role of governments, policy makers and regulators in establishing the objectives of these arrangements. Regularly assessing the impact of different policies on retirement income adequacy, using appropriate indicators, targets and thoroughly evaluating any shortfalls will also be necessary.

The sustainability and adequacy of pension systems includes making sure that workers in non-standard forms of work have the opportunity to save for retirement. This diverse population, including part-time and temporary employees, self-employed workers and informal workers, has more limited access to public and private retirement schemes and builds up lower retirement entitlements than do full-time permanent employees. Policy makers need to consider targeted measures, including facilitating access to retirement savings plans, offering dedicated or hybrid retirement savings products, allowing workers to keep the same plan upon job changes, allowing flexible contributions, and using nudges to remind people of the importance of saving for retirement.

The OECD is currently revisiting the *OECD Roadmap for the Good Design of Defined Contribution Pension Plans* to update its guidelines. These arrangements provide people with choice. They can for example, choose their preferred investment strategy for placing their retirement savings. However, when designing investment strategies, policy makers need to account for the fact that some people may be unable or unwilling to make choices, and select default investment strategies that protect them. Policy makers also need to establish a solid regulatory framework that ensures that people who change their investment strategies and pension funds are not negatively impacted with respect to their future retirement income. The regulation of financial advice can also be a means to ensure that any change in investment strategies is in their best interest.

Design of the default investment strategy and the provision of alternative investment strategies need to take into account the trade-off between maximising the expected retirement income and limiting the risk of people ending up with a low retirement income. People may end up in the default or may choose a different investment strategy; nevertheless, this calls for clear and consistent communication that presents people with trade-offs according to their risk profile and their level of risk tolerance, as well as their different retirement income arrangements and objectives.

People saving for retirement face longevity risk in addition to investment risk. Sharing these risks among stakeholders improves the sustainability and resilience of retirement savings arrangements. For risk sharing to be sustainable, it is important to have a regulatory framework that supports the objective of fairness in value transfers, the continuity of the arrangement through minimum funding requirements and the security of the promises.

The OECD continues to examine different policies to improve the sustainability and resilience of retirement savings arrangements. Sharing different experiences across countries, and disentangling what works and why, provides policy makers and regulators with concrete options based on international best practice.

KEY FINDINGS

Policy makers should balance the trade-offs between the short-term and long-term consequences of their responses to COVID-19

The broadened coverage of job-retention schemes and unemployment benefits has lowered the transmission of the labour market slump to public pension entitlements, but it will add pressure on public finances, already strained by demographic changes.

Policy makers should ensure that people continue saving for retirement and avoid selling assets and materialising value losses when markets fluctuate, and that pension providers act in accordance with their investment objectives. They should allow for regulatory flexibility in recovery plans to address funding problems, and ensure that funding and solvency rules are counter-cyclical. They should also provide proportionate, flexible and risk-based supervisory oversight coupled with adequate communication to reduce scams, and facilitate efficient operations (Figure 1).

Early access to retirement savings should be a measure of last resort based on individual exceptional circumstances. Accessing retirement savings could lead to materialising temporary asset values loses, liquidity and investment management problems to pensions funds, and, more importantly, to retirement income adequacy shortfalls.

Policy makers can promote the use of assets earmarked for retirement to support the economy, while ensuring that these investments are in the best interest of members.

Policy makers should adopt a framework to assess retirement income adequacy

Policy makers should have clear adequacy objectives and define what they intend for retirement income systems to achieve. They need to calculate adequacy indicators by projecting future retirement incomes that account for real-world uncertainty. Comparing indicators to targets helps determine whether individuals are meeting adequacy standards and the extent of any shortfalls. Suitable targets are those that are impartial, based on evidence relevant to a particular jurisdiction, and tailored to different types of individuals.

Policy makers should assess the performance of their retirement income system with reference to their policy goals. They should reflect on the arrangement's role in retirement provision, their tolerance for risks of shortfalls, and competing objectives when determining policy goals. Finally, they should address findings of inadequate retirement income.

They should conduct adequacy assessments regularly, identifying groups at risk and responding to their specific adequacy shortfalls.

The heterogeneity of workers in non-standard forms of work requires distinct approaches to help them save for retirement

Non-standard workers represent a very diverse population, including part-time and temporary employees, self-employed workers and informal workers.

They tend to build up lower retirement income because they have more limited access to public and private retirement schemes. Policy makers need to align the regulatory framework with the *OECD Core Principles of Private Pension Regulation* by ensuring non-discriminatory access to retirement savings plans, minimising vesting periods and facilitating the portability of pension rights and assets.

Options to encourage non-standard workers to join retirement savings plans include applying the same enrolment rules as for full-time permanent employees; facilitating access to retirement savings plans in the workplace; and offering dedicated retirement savings products.

Options to encourage them to contribute regularly include allowing workers to keep the same plan when changing jobs; allowing flexible contributions; offering hybrid products combining different savings motives; simplifying the contribution process; and using nudges.

Understanding the constraints that may prevent these workers from saving for retirement sheds light on which approaches may be more successful for different categories of non-standard workers (Figure 2).

Selecting default investment strategies involves the trade-off between maximising retirement income, upside potential, and limiting the risk of getting a low retirement income, downside risk

Default investment strategies are of critical importance to assist people in DC arrangements unwilling or unable to make investment decisions.

Solving the trade-off involves pre-selecting the candidate default investment strategies, assessing them using stochastic modelling to reflect uncertainty in outcomes, calculating indicators reflecting their potential riskiness and performance, and defining thresholds for risk indicators that reflect the importance given to the downside risk relative to the upside potential.

When designing the stochastic model, policy makers should carefully define parameters such as the simulation period, the types of risks to consider, the asset mix, the macro-economic scenario and the stochastic distribution of risk variables.

Figure 1. Challenges and responses: retirement savings in the time of COVID-19

Policy makers need to address the potential negative consequences of frequent switching of investment strategies

People often have significant flexibility in deciding how to invest their retirement savings in DC plans, and, under certain conditions, change their decision over time and transfer their accumulated retirement savings to different investment strategies or providers. This allows individuals to invest according to their own risk tolerance and investment horizon. People may look for external advice to help them make investment decisions.

Frequent trading typically results in worse investment outcomes. The possibility of frequent and large volume trading leads pension providers to hold more liquidity, preventing them from taking a long-term view, foregoing higher potential term and liquidity premiums. Frequent trading in high volumes can destabilise the market by affecting asset prices over the short term and increasing volatility.

Policy interventions to deter frequent switching may be needed to prevent harmful switching and preserve the stability of financial markets. Policies could target individuals, the design of the system, or potential external influences.

Sustainable risk sharing requires a regulatory framework supporting fairness in value transfers, continuity of arrangements and security of promises

Risk sharing, either between the provider and the participants or solely among the participants themselves, offers benefits in terms of risk mitigation and the level of expected retirement income as it increases the collective capacity to invest in higher risk assets that can provide a higher expected retirement income.

Designing risk sharing should promote fairness among participants and long-term continuity. Large value transfers can affect continuity by disadvantaging certain cohorts. Funding requirements limit the size of risk transfers, but reduce risk-bearing capacity. Defining minimum funding requirements involve defining a valuation methodology. Using the expected asset returns effectively allow expected risk premiums to be earned in the future to be spent upfront, and shifts value to current pensioners at the expense of future cohorts. Using the risk-free rate allows the risk premium to be spent once it has been earned, releasing any excess return to plan participants once the risk premium materialises

Funding requirements should reflect the strength of the benefit guarantees provided.

The regulatory framework needs to ensure the security of guarantees and reduce the risk of insolvency for participants. Guarantees provide additional certainty on benefits, but at the cost of lower capacity to invest in assets generating higher expected returns.

Consistent and standardised communication helps people choose investments

Communication about investment strategies, their associated risks, rewards and costs needs to be adapted to the target audience and avoid jargon and complex metrics. Standardisation helps people understand and compare different risk, return and cost profiles, and using default investment strategies as benchmarks can facilitate this comparison. The use of several risk indicators can create confusion rather than increase transparency. Visual aids are effective ways of communicating on the risk and return profile.

Associating qualitative characteristics to investment strategies may help individuals appreciate their risk and reward profile, but may also leave room for interpretation. Policy makers should provide a framework for providers to associate a qualitative assessment to the risk and return profile of investment strategies, based on the chosen indicators. They should also consider designing tools to assist people in determining their risk appetite when professional financial advice is not required.

Figure 2. Policy options to increase the role of retirement savings arrangements for different categories of workers in non-standard forms of work given the constraints they face

Part-time employees	May not prioritise retirement savings	• Avoid eligibility criteria based on earnings or hours of work in mandatory and automatic enrolment schemes
	Do not meet eligibility criteria of an occupational plan	• Allow employers to offer access to a personal plan to entire workforce
	Reduced capacity to save	• Frame contributions in low frequent amounts
Temporary employees	May not prioritise retirement savings	• Avoid eligibility criteria based on contract length or type in mandatory and automatic enrolment schemes • Offer hybrid products + send reminders
	Need portability	• Encourage multiple employer plans • Encourage collective agreements in occupational plans • Allow employers to contribute to personal plans
	Need flexibility	• Allow flexible contributions + send reminders
	Reduced capacity to save	• Frame contributions in low frequent amounts
Self-employed workers	Do not have an employer to set-up a plan and contribute to it	• Offer dedicated products • Encourage platform providers to offer personal plans to their contractors
	May not prioritise retirement savings	• Offer hybrid products + send reminders
	Need portability	• Allow contributions into the occupational plan of a former employer
	Need flexibility	• Allow flexible contributions + send reminders
	Do not benefit from automatic payroll deductions	• Set automatic savings mechanisms using digital services and platforms already used to run the business
	Reduced capacity to save	• Frame contributions in low frequent amounts
Informal workers	Not covered by mandatory schemes	• Offer dedicated products
	Need portability	• Allow employers to contribute to personal plans
	Need flexibility	• Allow flexible contributions + send reminders
	May not prioritise retirement savings	• Set automatic savings mechanisms through consumption • Increase the number of contribution channels
	Reduced capacity to save	• Frame contributions in low frequent amounts

RETIREMENT SAVINGS IN THE TIME OF COVID-19: STRIKING A BALANCE BETWEEN THE SHORT TERM AND THE LONG TERM

COVID-19 has created many challenges to retirement savings arrangements. Its knock-on effects on the economy and financial markets reduced the level of assets in retirement savings plans in the first quarter of 2020. Liabilities of plans guaranteeing a level of retirement benefits are likely to grow as interest rates have fallen further. COVID-19 has also affected the ability of workers and their employers to contribute into their retirement savings plans. In addition, policy makers, regulators, supervisors and pension funds face operational disruptions due, for example, to the adjustment to working remotely. They are also exposed to cyber-attacks, and together with individuals saving for retirement, to frauds and scams. There is also the risk that people prioritise their short-term needs over their long-term well-being, taking all opportunities available to stop, reduce or postpone contributions and withdraw their retirement savings early. Finally, there are calls on pension providers to invest in local businesses, infrastructure projects, and post COVID-19 recovery projects, which could potentially increase the risk profile of retirement savings portfolios.

These challenges have led policy makers to take several policy measures. A number of them intend to protect plan members, retirees and pension providers, and ensure the sustainability of retirement savings schemes, while others may jeopardise future retirement income adequacy.

Measures ensuring the long-term sustainability of retirement savings schemes include those that subsidise contributions to retirement savings plans in a time where it may be harder for members or their employers to contribute. Others aim to avoid locking in short-term investment losses and losing the opportunity to recoup losses when financial markets bounce back. Policy makers have also given flexibility to pension providers to secure solvency, and to allow them to deal with pressing issues given the operational challenges that come with confinement and social distancing measures.

However, some of the measures implemented, while providing short-term relief, may have a lasting impact on the well-being of future retirees, in particular, on retirement income adequacy. These measures include those allowing employers and individuals to defer, reduce or stop pension contributions, as well as those allowing individuals to access their retirement savings early.

The response to the decline of asset values in retirement portfolios is to stay the course and avoid materialising value losses by selling. Saving for retirement is for the long haul. Fluctuations in asset values are inevitable during the life of a retirement portfolio. Over the long-term, portfolio investment provides a return to retirement savings. Selling assets when shocks occur may lead to materialising the reduction in value and precludes opportunities to recover those losses.

Pension providers should also stay the course and maintain their investment strategies. All pension providers should have an investment policy establishing clear investment objectives consistent with their retirement income objective and liabilities, and at arm's length from governments. It is important that pension providers act in accordance with these investment objectives to be able to deliver on their promises and maintain trust in the system. Pension providers should maintain diversified investments and carefully assess new investment opportunities linked, for example, to the post-COVID-19 recovery, and not engage in those for which they lack the skills and expertise to assess the risks and rewards appropriately.

It is important to allow for regulatory flexibility in recovery plans to address liability problems stemming from retirement promises. Regulatory rules, including mark-to-market valuation principles and recovery plans, remain essential for the long term but need to be flexible during exceptional circumstances. However, it is also important to reverse that flexibility once the exceptional circumstances have faded. Additionally, funding and solvency rules for DB plans should be counter-cyclical. Introducing flexibility in meeting funding requirements would help to avoid 'pro-cyclical policies' and allow pension funds to act as long-term investors and potentially stabilising forces within the global financial system.

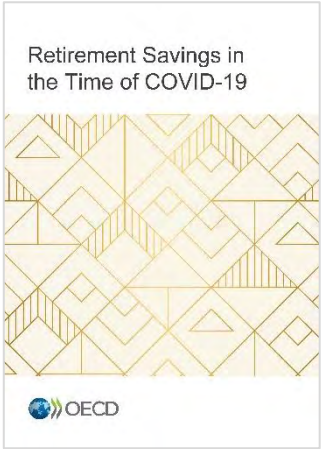
Measures such as contribution holidays and early access to retirement savings accounts may affect the adequacy of future retirement income. It is important to limit early access to balances accumulated to finance retirement as much as possible. The goal of retirement savings plans is to finance retirement. Allowing withdrawals from retirement pots before retirement may lead not only to lower retirement income adequacy but also to materialising asset value losses, as well as liquidity and investment management disruptions.

Early access to savings in retirement plans should be a measure of last resort. Notwithstanding this, there can be room for the need for flexibility in exceptional personal circumstances. Many jurisdictions already include provisions allowing for partial withdrawals of retirement savings based on specific exceptional circumstances: hardship situations like unemployment accompanied by protracted and large losses of income, or terminal illnesses. These programmes should be maintained for people who need them most.

Policy guidelines

- Saving for retirement is for the long term. Maintain investments in retirement portfolios to avoid selling and materialising value losses when markets are low.
- Continue contributing to retirement plans. Governments subsidising wages may want to extend the subsidies to cover contributions paid by both employees and employers, as part of the many programmes to assist people facing the economic fall from COVID-19.
- Act in accordance with investment objectives. Pension providers should adhere to their investment objectives and carefully assess new investment opportunities. Their investment decisions should be at arms-length from governments.
- Allow for regulatory flexibility in recovery plans to address funding problems stemming from retirement promises. Make sure that once the emergency is over, measures providing flexibility are removed.
- Make sure that funding and solvency rules for DB plans are counter-cyclical. Introduce flexibility in meeting funding requirements, thereby avoiding 'pro-cyclical policies' and allowing pension funds to act as long-term investors and potentially stabilising forces within the global financial system.
- Provide proportionate, flexible and risk-based supervisory oversight coupled with adequate communication to reduce frauds, and facilitate efficient operations.
- Allow access to retirement savings as a measure of last resort and based on individuals' specific and exceptional circumstances.
- Develop close co-operation with stakeholders, regulators and supervisors, at the national and international levels, to share solutions and effective ways to deal with the current crisis.
- Promote the use of assets earmarked for retirement to support the economy, while ensuring that these investments are made in the best interest of members.

Retirement Savings in the Time of COVID-19



This complementary publication examines how COVID-19 has affected retirement savings and old-age pensions, and how policy makers have tried to cushion its impacts on workers, employers, retirees and pension providers.

Chapter 1. Old-age pensions and COVID-19

Chapter 2. Retirement savings and COVID-19

Chapter 3. Using assets earmarked for retirement to support COVID-hit economies

For more information, please contact

Mr. Pablo ANTOLIN - Senior Economist and Head of the Private Pensions Unit
OECD Directorate for Financial and Enterprise Affairs

Pablo.ANTOLIN@oecd.org

Ms. Stéphanie PAYET - Analyst, Private Pensions Unit
OECD Directorate for Financial and Enterprise Affairs

Stephanie.PAYET@oecd.org

Ms. Jessica MOSHER - Analyst, Private Pensions Unit
OECD Directorate for Financial and Enterprise Affairs

Jessica.MOSHER@oecd.org

The 2020 edition of the OECD Pensions Outlook examines a series of policy options to help governments improve the sustainability and resilience of pension systems. It considers how to ensure that policy makers balance the trade-off between the short-term and long-term consequences of policy responses to COVID-19; how to determine and assess the adequacy of retirement income; how funded pension arrangements can support individuals in non-standard forms of work to save for retirement; how to select default investment strategies; how to address the potential negative consequences from frequent switching of investment strategies; and, how retirement income arrangements can share both the investment and longevity risks among different stakeholders in a sustainable manner. This edition also discusses how governments can communicate in a way that helps people choose their optimal investment strategies..

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