PensionsEurope comments to OECD analysis of policy measures to contain costs of running funded private pension plans (DAF/AS/PEN/WD(2017)5)

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www.pensionseurope.eu

About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace pensions. Some members operate purely individual pension schemes. PensionsEurope Members are large institutional investors representing the **buy-side** on the financial markets.

PensionsEurope has **24 member associations** in 19 EU Member States and 3 other European countries with significant – in size and relevance – workplace pension systems[1].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people.** Through its Member Associations PensionsEurope represents more than **€ 4 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **25 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

What PensionsEurope stands for

- A regulatory environment encouraging workplace pension membership;
- Ensure that more and more Europeans can benefit from an adequate income in retirement;
- Policies which will enable sufficient contributions and good returns;

Workplace pensions offer

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often "not-for-profit" and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

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[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Lithuania, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden, UK. Non-EU Member States: Iceland, Norway, Switzerland.

1. Introduction

PensionsEurope welcomes the OECD analysis of policy measures to contain costs of running funded private pension plans (DAF/AS/PEN/WD(2017)5) that was also discussed in the last meeting of the OECD Working Party on Private Pensions (WPPP) on 20 June 2017. Several participants commented on the differences between nonprofit pension funds and for-profit organisations and participants agreed that they are different in their nature in many different ways. In our below comments, we would like to further stress these differences and specificities of nonprofit pension funds.

Furthermore, the OECD analysis contains a reference to Better Finance Report “Pension savings – the real return, 2016 edition” which PensionsEurope commented in April 2017. In our remarks, we particularly highlighted numerous specificities that the research should take into account in order to give a realistic picture of the quality and outcome of pension savings.

2. PensionsEurope general comments

Aim of the project

We welcome that this project which focuses on cost does not necessarily promote low costs, but sees cost in relation to benefits. We agree that lower costs are not always better, and that pressure on cost can lead to lower quality service / lower benefits.

Scope of the project

We note that no clear distinctions are made between occupational and personal pensions. While of course low costs and value for money are desirable in both systems, their structures are different and these issues therefore need to be addressed differently. The main difference is that in occupational pensions the employer and/ or social partners play an important role, both generally and also specifically in relation to cost. An employer for example might decide to use in-house staff for certain services, thereby covering costs which under a third pillar product would have to be borne by the individual; if a defined benefit promise is exclusively financed by the employer, costs play little to no role for the beneficiary. Employee representatives are important in second pillar pensions, and they have no equivalent in the third pillar. Because of these differences, it is crucial to clearly distinguish between occupational and personal pensions for this project. While throughout the paper it seems that it is focused on occupational pensions, the title is still covering both pillars (“funded private pension plans”).

Differences between DB and DC

The title „… costs of running funded private pension plans“ means that the project covers funded schemes regardless of the type of pension promise they make. The introduction states that the scrutiny of charges has increased with the rise of DC pension plans, but that it is also desirable to keep costs at a reasonable level for DB schemes. We agree that despite the different structures, some of the cost-containing measures which work for DB might also work for the DC and vice versa.

However, we would like to stress that the structural differences relevant for cost-containment do not stop at the DB/DC distinction. Other questions like the level of involvement of the employer, the form of financing as well as governance structures are important as well. We would therefore welcome a more granular approach to different occupational pensions systems than a DB – DC divide, taking into account the diverse landscape in between those two extremes. Importantly, this should be taken into account for any policy recommendations.

Assumptions

The paper assumes that it is possible to measure cost and standardise the cost structure relevant for the benefits. It might not be possible to compare the costs of two pension schemes because their structure differs too much: if for example an employer uses in-house staff to do pension scheme administration, this represents a quantifiable cost, but it is not relevant for the members of the pension scheme. In this case, the administration costs are a pure cost to the employer; they do not have an impact on the benefits.

If an employer sets up and runs a traditional DB scheme, he often bears the related costs. Questions around cost are therefore not a primary concern for the members / beneficiaries. We therefore see no need to standardise cost measurement for these traditional DB schemes.

Governance

The OECD describes the potential problems arising from weak governance (p. 13). We agree that good governance is important and would like to encourage the OECD to refer to more examples in this regard.

Agency problems

We notice the agency problems raised in paragraph 37. Is there evidence that these issues in practice exist? Since they are quite strong accusations, it might be better to support them with evidence or drop them.

3. PensionsEurope comments to OECD on costs and specificities of nonprofit pension funds

Please find below some excerpts from PensionsEurope remarks about Better Finance Report “Pension savings – the real return” containing our key arguments on costs and specificities of nonprofit pension funds, which we think are very relevant to the OECD analysis as well.

PensionsEurope would like to stress that it is of utmost importance to make a distinction between retail products and pension arrangements offered in the second pillar. While personal pensions are often bought as products, occupational pensions and collective second and third pillar pensions in Central and Eastern Europe (CEE) are benefits provided by employers to their employees – in some countries voluntarily, in others based on legislation or tariff agreements. In fact, no matter how a pension product (with the main goal to provide for income after retirement instead of just aiming at maximizing the investment yield as in other investment vehicles) is marketed (as a collective, employer, occupational, workplace plan, employment-related), it should be excluded from the financial legislation of pure retail financial products and services. Furthermore, pension funds are first and foremost institutions with a social purpose, and they should not be treated as purely financial service providers. This is also laid down in the recently adopted IORP II Directive (see the Recital 32 of the IORP II Directive[2]):

IORPs are pension institutions with a social purpose that provide financial services. They are responsible for the provision of occupational retirement benefits and should therefore meet certain minimum prudential standards with respect to their activities and conditions of operation, taking into account national rules and traditions. However, such institutions should not be treated as purely financial service providers. Their social function and the triangular relationship between the employee, the employer and the IORP should be adequately acknowledged and supported as guiding principles of this Directive.

PensionsEurope stresses the role of sponsoring employers and trustees or governing bodies in running collective pension plans. The main purpose of pension plans is to provide a retirement income for the individual member. With regard to workplace pensions, next to the asset side of the balance sheet, liabilities are also important - as well as longevity trends/risk, interest rate (for conversion into pension/annuity), and inflation. Therefore, PensionsEurope stresses that it is important to take into consideration liability matching, risk appetite, diversification, regulatory requirements or any of the other factors that go into investment strategy of workplace pensions.

In general, asset allocations differ amongst nonprofit pension funds because of various reasons, including: general risk appetite (which depends on the decisions of the management boards including stakeholders in the boards of pension funds), inclusion of guarantees (if a guarantee is given, this will impact on the asset allocation), regulatory requirements, liquidity (for example, local regulation recognises the participant’s right to switch among different personal plans), and other factors.

Comparing the retirement systems of different countries is a very complex exercise; it includes an overview of social security systems, characteristics of the labor market, the way of organising pensions, the nature of the pension promises (e.g. guarantees and risk sharing) etc. As all of these elements help to define the plan design, the pension vehicle, and the asset allocation, they also impact on the returns: x% return might be very good in one system but rather poor in another system.

When researching the costs of nonprofit pension funds, one should also at the same time look at the benefits. When comparing pension savings, not only their return should be compared, but also what they offer to their beneficiaries (in the second pillar) or their consumers (in the third pillar).

[2] See Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast).

Finally, we would like to stress the impact of a persisting low interest rate environment which puts a serious strain on pension savings and should be considered in the analysis.

We invite OECD to take into account our above-mentioned remarks in its analysis and we are happy to provide further information, if needed. We are also looking forward to further discussions about costs and specificities of nonprofit pension funds in the next meeting of WPPP in Paris on 4-5 December 2017.