Principles for Securing Good Outcomes for Members of Defined Contribution Pension Plans throughout Europe
Across Europe there is a growing trend towards the establishment of defined contribution (DC) pension plans for second pillar, workplace pension provision. Millions of citizens across Europe already rely upon workplace DC pension plans to supplement the pension benefits that they receive from the State. In light of the increasing reliance on workplace DC pension plans throughout Europe, it is essential that individuals can have confidence that workplace pension plans operate in their interests, are robust, well run and offer value for money. As we explore here, this should ensure that the individual members will have good outcomes that will address their needs in retirement.

For employers that offer workplace DC pension plans, they too need to have confidence that these plans are robust, well run and offer value for money. Employers also need confidence that their plan will remain affordable, that it will not expose them to unforeseen risks and that it will be flexible enough to enable them to achieve their HR and business objectives and accommodate how these develop over time.

PensionsEurope aims to be the thought leader in Europe and beyond on workplace pensions and we present this paper as a contribution to the evolution of DC pension plans, and a natural follow on from our previous papers on Pension Design Principles applied to modern Defined Contribution solutions and Key Principles of Good Governance for Workplace Defined Contribution Pension Plans throughout Europe. Through our Member Associations and our Corporate and Supporter members we have access to resource and expertise that we will use to further the debate on DC pension plans and help to ensure better outcomes for members.

PensionsEurope chair
Janwillem Bouma
8 June 2017
Across Europe there is a growing trend towards the establishment of defined contribution (DC) pension plans for second pillar, workplace pension provision. Millions of citizens across Europe already rely upon workplace DC pension plans to supplement the pension benefits that they receive from the State. This number is likely to continue to increase significantly in the coming decades, as employers look for a less risky alternative to defined benefit pension plans and governments across Europe consider ways to help close the gap that is emerging – for economic and demographic reasons - between state pension provision and citizens' income needs in retirement.

In light of the increasing reliance on workplace DC pension plans throughout Europe, it is essential that individuals have confidence that workplace pension plans operate in their interests, are robust, well-run and offer value for money. Ultimately, as we explore here, this will ensure good outcomes for members that will allow them to retire without experiencing an unexpected drop in living standards.

Generally speaking, it is for an employer to decide whether to offer a workplace DC pension plan to its employees. Consequently, employer engagement is critical to the success of such plans. Employer contributions are a key incentive to encourage their employees to join, and remain in, the plan and they help to boost their employees’ retirement funds. For employers to continue to offer workplace DC pension plans, they too need to have confidence that these plans are robust, well run and offer value for money. Employers also need confidence that their plan will remain affordable, that it will not expose them to unforeseen risks and that it will be flexible enough to enable them to achieve their HR and business objectives and accommodate how these develop over time. A stable fiscal, legal and regulatory environment is an important element of this.

The first issue to address is what constitutes a good outcome. The purpose of a pension system, as a whole, is to aim that people have sufficient funds to live comfortably in retirement when they are no longer earning or are earning less. The most basic requirement is that they have sufficient funds available to ensure they are not living in poverty. This can sometimes be the role of the State through the First Pillar pension, although the level of State provision differs significantly from country to country. In addition to this, employers will often play a role in helping employees save for retirement by establishing pension plans for their employees, where the employer and employees set aside some of their pay to be used in retirement rather than while working. Most countries do not tax the element of salary that has been set aside until it is
actually received by the employees and this is the EET system of not taxing the employee and employer payments to the pension plan or the investment returns on the plan, but taxing the income when it is paid in retirement. Other countries operate different systems such as TEE where the contributions to a pension plan are made from post-tax income and the investment returns and benefits are then not taxed.

Traditionally, in both Defined Benefit (DB) plans and DC plans, the benefit provided at retirement was a life-long stable payment, in the form of a pension paid from a DB plan or an annuity purchased with the proceeds of a DC savings pot. A DB plan provided some element of certainty to participants as there was a defined benefit structure, usually based on the employee’s length of service and salary at retirement. However, the certainty afforded by DB plans depends on the plan being fully funded and the willingness of the employer to carry this risk. Funding difficulties and the subsequent decline of DB plans have removed this certainty. Clearly, DC plans cannot provide the same level of certainty as the outcome will depend on the contributions made to the plan, the investment returns, the level of charges and economic conditions such as inflation and interest rates during retirement. Furthermore, changing work patterns where the DC plan may be only one of many elements of an individual’s retirement savings, coupled with increasing longevity, make planning less certain. With this in mind, it may be that the ultimate measure of a good outcome in a DC pension plan is that the plan provides the participants with a realistic expectation of the benefit they will receive at retirement and a reasonable chance of receiving this benefit.

There are many elements that feed into ensuring this good outcome. These include the plan design, good governance structures, administration systems, appropriate investment options (if granted), value for money in terms of charges and appropriate retirement options (if granted). A variety of stakeholders - employers, those responsible for the governance and running of the plan, third-party service providers and employees all have an interest and role to play in these areas.

For the purposes of this paper we have treated a workplace DC pension plan as an arrangement:

- that is established or chosen by an employer for its employees, often in conjunction with those employees or their representatives
- under which employees build up their own individual pension account, and
- where there is no promise about the level of benefits that an employee’s account will ultimately deliver – and, therefore, no liability on the employer or the plan to deliver a particular level of pension benefit.

However, some or all of these principles may equally apply to other types of workplace or individual pension plans.

This paper focuses on many aspects of workplace DC pension plans and it should be read alongside our paper on the design principles for DC plans, *Pension Design Principles applied to modern Defined Contribution solutions* and the paper on *Key Principles of Good Governance for Workplace Defined Contribution Pension Plans throughout Europe*. 
2. Key stakeholders

As mentioned in the previous chapter, there are several parties that have an interest in workplace DC pension plans delivering good outcomes. These include:

**Employers**
Generally speaking, it is the employer, whether or not with collective bargaining, who chooses a workplace DC pension plan for its employees and agrees to bear some or all of the related costs. Many employers will want to ensure that the pension plan they choose and contribute to on behalf of their employees is well run, offers value for money, and delivers a good quality service.

In any event, all employers have a self-interest in ensuring their plan achieves good outcomes in order to:

- help them to recruit and retain staff
- help them to get maximum value from their pensions spend and stand out from their competitors when seeking to attract and retain talent
- help them to achieve their HR objectives related to succession planning by making it more likely that employees will be able to afford to exit the labour market at the end of their working lives
- mitigate the risks of any potential liability arising from the poor operation of the plan, and
- enhance their reputation with employees and externally.

**Employees and other beneficiaries**
Given the increasing reliance on workplace DC pension plans throughout Europe, it is crucial that they deliver good outcomes for individuals and help them to plan and prepare for their retirement. It is also essential that individuals know that someone is charged with ensuring that the plan is operated in their interests and that it is delivering value for money. This is particularly important in the context of workplace
DC pension plans where competition alone cannot be relied upon to deliver this due to:

- the complexity associated with different pension plans, which can make it difficult for individuals and employers to make the right choices,
- employers (not individuals) deciding which pension plan to use, and
- employees who typically do not have the opportunity to shop around to find a better pension plan and who are not usually in a position to negotiate better terms.

With vast sums being invested in workplace DC pension plans it is also essential, both for employees and the European economy, that these funds are invested appropriately, and safeguarded to ensure the security of individuals’ retirement savings. It is also critical that individuals are given the right information at the right time during their saving lifecycle to enable them to manage their savings, plan for their retirement and, where there is a choice available, make informed decisions about how best to use their savings in later life.

If participants in plans are required to make choices that impact on them individually, they take on specific risks. A well run plan, as set out in this paper, will allow them to mitigate some of those risks. It is important that participants can be assisted in evaluating their own risk profile, are educated about and informed of the risks they take and also that they understand that, in order to achieve good outcomes in terms of the growth of their fund, they may well have to invest in return seeking assets carrying a level of risk.

**Those responsible for running or overseeing the plan**

Those legally responsible for running or overseeing workplace DC pension plans – which may, depending on the jurisdiction, include pension funds, fiduciaries (such as trustees), employers, employee representatives, trade unions, insurance companies, asset management companies and other commercial entities - also have a clear interest in the success of these plans, and in the long-term success of and confidence in pensions saving in general. In particular, they have an interest in ensuring that plan members receive good quality service, good outcomes and value for money. Without this, those who run or oversee such plans face criticism and potential liability for poor performance. They also jeopardise the retirement prospects of their members, risk their reputation, increase the need for regulatory intervention and risk undermining trust and confidence in workplace pensions. Service providers also carry commercial risk if they fail to deliver on the services they are supposed to provide to the plan.

**Policymakers and those responsible for regulating workplace pension plans**

Policymakers, regulators and supervisory authorities have an interest in ensuring that workplace pension plans are well run, well governed and are trusted by individuals and employers. They also have an interest in ensuring that workplace pension plans deliver good outcomes and contribute to long-term economic stability. This is increasingly becoming a priority for regulators who are focusing on plans achieving value for money and good outcomes. They need to find a balance to ensure plans are properly regulated and well governed, whilst also ensuring that regulation is proportionate and doesn’t have a negative impact on member outcomes.
3. Principles

**Principle 1: Plan Design**

**Plans should be designed with good member outcomes in mind and focus on the needs of participants in retirement**

The paper *Pension Design Principles applied to modern Defined Contribution solutions* focuses on the issue of plan design in greater detail.

Workplace DC pension plans should be designed with good member outcomes in mind. The potential desired outcome will vary according to factors such as the level of State pension, the type of employees that will be participating and other savings employees are likely to have. All of these factors will determine the needs of the individual in retirement. They also mean that it can be difficult to establish a single figure that an individual should aim for as a replacement income in retirement. However, the plan should consider what the objectives of the plan are for its participants.

Employers will then, where there is a choice, and often in conjunction with trade unions or employee representatives, determine the contribution rates and investment structure that has a reasonable chance of achieving the level of retirement income needs that they believe is appropriate. In some countries there may be a legal requirement that determines the contribution rate.

The ultimate pension outcome also depends on the time over which contributions are paid into a DC pension plan. The earlier employees start to save for their retirement, the higher the pension outcome will be in the end. A sound default architecture is important in this respect. Automatic-enrolment or an opting-out system when participants are starting their career, might be solutions to make sure that employees start to save for their pensions sooner rather than later.

“It can be difficult to establish a single figure that an individual should aim for as a replacement income in retirement. However, the plan should consider what the objectives of the plan are for its participants.”
Principle 2: Communication

Communications should be clear so that participants can understand the benefits of the plan and, where they have to make choices, they can do so on an informed basis and appreciate the impact of the choices they are making.

Communication is an integral part of ensuring that participants in plans have a clear understanding of what they can expect at retirement and their responsibilities in achieving this. Communication should set out the risks and also the benefits of, where possible, increasing contributions. If joining a plan is voluntary, the risks of not joining should be made clear, along with the benefits of joining. Those managing plans communicate with participants on an ongoing basis so that they can track their progress towards their goals. Technology such as modelling tools can be used to help participants establish those goals. Rules in this respect could also allow for providing information online, in a user friendly format.

Communication is about more than just imparting information. It should aim to engage and educate the participants so that they can understand the choices they have to make and the benefits they are likely to receive.
Communications should always be clear and balanced so that participants have the ability to plan, but also understand that projections depend on many assumptions which are more likely than not to be incorrect. Communications should also spell out, where participants have options, what those options are and the impact of them. Participant options range from whether to join the plan, the level of contributions they can make, where those contributions can be invested and benefit options when they leave the employer or retire. The options chosen by participants will have a significant impact on their outcome and plans should ensure participants can understand these in order to make the right decisions for themselves. Participants should be assisted in establishing their risk profile and the options they choose should be consistent with that risk profile. Plans may have automated features that establish risk profiles and suggest appropriate options.

Some plans will make financial advice (which may be regulated advice under MiFID or other regulations), or other forms of guidance available to members. It is important, where advice is given, that it is given by someone who is authorised and competent to do so. There may also be specific issues in relation to communications with participants who are no longer employed by the sponsor.

Because employees today are more likely to have varied careers and, sometimes, different types of employment (including self-employment), it is important that they consider all of their pension savings when planning and building an understanding of their needs in retirement. As this is personal data that only they will have, the obligation is on the individual to keep track of this and factor it into any decisions they make about contribution levels, investments and decumulation choices (where these exist).

**Principle 3: Administration**

**Administration of DC plans is complex and administration systems need to be robust to ensure benefits are accurate**

Proper administration is also key to ensuring good outcomes. The number of transactions that occur in DC plans tends to be large and these need to be recorded and correctly applied to ensure that participants will receive the correct benefits. Participants’ choices need to be correctly recorded and administered. The correct contributions need to be calculated and deducted from salaries and passed onto the plan for investment. These then need to be invested correctly, in a timely manner and in accordance with the participants’ instructions, where they have a choice. Changes in contributions due to salary changes or changes in the contributions levels need to be administered properly in payroll and then invested correctly. If the plan decides to change investment managers, the administrator needs to ensure any transition of funds is carried out correctly. Administration systems need to be robust and capable of handling and recording tens of thousands of transactions. As administrators are often responsible for participant communications they need to ensure they are extracting the correct information to give to members. If a participant is leaving employment or retiring, the administrator is often responsible for calculating the options available to the members at that time. As this relates to the ultimate member outcome, it is paramount that it is done accurately with any tax, legal and regulatory rules applied correctly. All payments should be made promptly.
Those responsible for the running of the plan should ensure there are adequate service levels provided and, if this aspect is outsourced, that there are agreements in place with the administrator. There should be appropriate checks and controls in place to ensure the plan is properly administered. There should be regular monitoring and assessment of the administrator.

Plans should ensure that agreements with all service providers are legally sound with clear lines of responsibility to ensure accountability.

**Principle 4: Investments**

**Investments should be appropriate and suitable to the members’ needs. Where the members have to make choices they should be provided with assistance that enables them to make informed choices**

Assets should be invested prudently with an appropriate number of suitable investment options made available where individuals make investment decisions, including a suitable default strategy where necessary. Plans should consider whether to have lifestyle strategies in place whereby participants are increasingly subjected to less risk as they approach retirement. Traditionally this would have involved moving to “safer” investments as well as investments that most closely match the benefits the participant is likely to receive in retirement. This can be more difficult where there are different decumulation options available to participants, and plans should consider whether they should adapt more than one lifestyle strategy to cater for those options.
In determining investment strategies and options to make available to participants, plans should consider the balance between having liquid investments that allow for easy divestment and regular pricing, and the long term nature of pension investments. Plans should consider whether making more illiquid investment options might offer them better returns and increase the ultimate outcomes. Plans should also consider Environmental, Social and Governance factors when deciding on investment strategies and options to make available to participants.

Plan investments and investment options should be monitored and reviewed regularly with costs and charges assessed to ensure they represent value for money. Value for money can be difficult to quantify, but those responsible for running or overseeing the plan should ensure that all the investment options that are available are appropriate to the participants. They should consider issues such as whether they offer passively or actively managed funds. They should consider the charges that apply to funds and ensure that the inclusion of funds with higher charges can be justified. They should also question whether charges appear to be too low. From a value for money perspective, what is important relative to charges, is what is being provided for those charges. Are there additional service aspects or proven and sustainable investment outperformance that merit higher charges? Net investment performance should be monitored to ensure performance is as expected, when compared with the intended outcomes and risk profile of the funds.

“Plans should also consider Environmental, Social and Governance factors when deciding on investment strategies and options to make available to participants.”
**Principle 5: Costs and Charges**

**Costs and charges should be appropriate and should represent value for money**

There are many areas in the establishment and ongoing management of plans that will incur costs and charges. These can range from set-up costs, legal, consultancy, administration, regulatory and investment fees. Transparency about these costs is essential. Some of these costs may be covered by the employer or plan sponsor but some will come from the participants’ funds. Those responsible for running the plan have a responsibility to ensure all costs are appropriate as they will impact on the members’ outcomes. Costs and charges and the services provided for those costs and charges should be reviewed on a regular basis. The costs and charges should be evaluated to ensure they provide value for money and, if possible, benchmarked against costs and charges paid by similar plans.

It is also important to try to distinguish all of the charges that might apply to the fund. The headline fixed percentage of assets under management is usually easy to ascertain. However, there may be transaction costs that also apply to the fund. As far as is possible, these should also be ascertained as their impact forms part of the overall assessment of value.
Principle 6: Decumulation

Retirement options should be appropriate and, where members have choices to make, the impact of those choices should be clear

The purpose of any pension plan is to pay retirement benefits to the participants and/or their dependants. Those benefits come in many formats such as lifetime annuities, cash amounts, drawdown options, remaining invested in the plan or combinations and varieties of these. In the interests of achieving outcomes for beneficiaries, many workplace DC pension plans offer participants a choice over how to use or access their pension account on retirement. These options should be assessed by those running or overseeing the plan to ensure that, as far as possible within the constraints of the applicable legal, tax and regulatory framework, they offer value for money and deliver good outcomes. The suitability of these options and whether they continue to offer value for money should be reviewed regularly.

Participants should be given clear information that can help them to make informed choices. If feasible, plans or employers may make advice or guidance available to participants, may offer benefits from within the plan or have preferred products where they have negotiated favourable terms.

The idea of continuing to invest DC funds (wholly or partially) after retirement from work is an interesting area worthy of further consideration in the development of modern DC plans. It could help to avoid a one off conversion risk at retirement, and potentially bring the possibility of higher investment returns after retirement, and the (collective) sharing of longevity and/or investment risks in the pay-out phase.
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 systems¹.

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.

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

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

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.