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The OECD Roadmap for the Good Design of Defined Contribution Pension Plans

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This roadmap has been approved and endorsed by the OECD Working Party on Private Pensions in June 2012

Overall retirement income adequacy depends on pension plans benefits

- Private pension plans are increasingly an integral part of most countries' overall pension system - and for some they are the main component.
- The OECD Working Party on Private Pensions has identified elements of good design and public policy to assist countries strengthen retirement income adequacy in a defined contribution environment.

1. Ensure the design of Defined Contribution pension plans is internally coherent between the accumulation and payout phases, and with the overall pension system.

- **The target retirement income in DC plans should be determined consistently with the benefits provided by the other components of the pension system.**

- **To define and achieve this target, all possible risks (*i.e.*, labour, financial and demographic risks) affecting retirement income of DC pension plans should be monitored.**

2. Encourage people to enrol, contribute and contribute for long periods.

- Where mandatory enrolment is not considered opportune, mechanisms such as automatic enrolment and opt out options are particularly useful, together with setting adequate default contribution rates.

- Making sure people contribute for long periods with sufficiently high contribution rates is the most effective way to improve their chances of obtaining an adequate replacement rate from DC pension plans.

- This goal needs to be complemented with “work longer” policies.

3. Improve the design of incentives to save for retirement, particularly where participation and contributions to DC pension plans are voluntary.

- **Appropriate tax incentives, including financial subsidies for the low paid, and/or matching contributions, can both work as efficient mechanisms to encourage participation and increase contributions.**

4. Promote low-cost retirement savings instruments.

- Policymakers need to ensure incentives are in place to improve efficiency and reduce costs in the pension provision sector.
- Disclosure-based initiatives should be promoted, but may need to be complemented with appropriate tender mechanisms or default allocation to low-cost providers, especially in compulsory or auto enrolment systems.
- In certain pension structures, cost issues can be addressed by establishing large pension schemes, run on a non-profit basis.

5. Establish appropriate default investment strategies as well as investment options with different risk profiles and investment horizons.

- As many members may be unwilling or unable to choose investments, default options need to be carefully designed following the lessons learnt from behavioural economics.
- But if they wish, people should be allowed to choose the investment strategy best suited to their risk profile and level of risk tolerance, as well as their different overall pension arrangements.

6. Consider establishing default life-cycle investment strategies as a default option to protect people close to retirement against extreme negative outcomes.

- Life-cycle investment strategies reduce the impact of market risk on the account balance as the member ages.

- Such a design is consistent with economic rationale and risk attitudes and is therefore well-suited for default strategies.

7. For the payout phase, encourage annuitisation as a protection against longevity risk.

- A certain level of annuitisation of balances accumulated in pension plans should be set as the default mechanism for the payout phase, unless PAYGO public pensions, or the old-age safety net, already provide for sufficient regular pension payments.

- An appropriate default could be combination of programmed withdrawals with a deferred life annuity (e.g. starting payments at the age of 85) that offers protection against inflation.

- The demand for annuities could be promoted through financial education stressing that they are insurance products designed to protect people from outliving their resources.

- Lump-sum payments may have to be discouraged as a form of benefit pay-out, except for small DC account balances.

8. Promote the supply of annuities and cost-efficient competition in the annuity market.

- Different providers, such as public schemes, non-profit occupational plans, and insurance undertakings may have different risk-sharing arrangements in the payout phase that may help strengthen benefit adequacy and diversify risks in retirement income.

- Competition among different providers in the market for individual and group annuities should be promoted to ensure cost-efficient provision for plan members and to help develop the annuity sector as a whole.

9. Develop appropriate information and risk-hedging instruments to facilitate dealing with longevity risk.

- The market for annuities would benefit from making it easier to manage longevity risk by:
  - Availability of statistically reliable life tables that are regularly updated and incorporate forecasts of future improvements in mortality and life expectancy.
  - Promotion of capital market solutions by producing standardised, publicly and readily available longevity indices.
  - Possibility of issuing longevity indexed bonds and very long-term bonds

10. Ensure effective communication and address financial literacy and lack of awareness.

- Effective communication includes providing regular individualised benefit statements.
- Make available clear benefit projections under prudent assumptions, informing members about the possible impact of higher contributions or later retirement on their benefits.
- Provide free and ready access to comparative information about costs and performance of different providers.
- Use language that can be readily understood by pension plan holders.