Network for Studies on Pensions, Aging and Retirement

The Pan European Personal Pension (PEPP) product and its impact in four European countries

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Pan European Personal Pension plans

- EIOPA has proposed new regime for pension provision in all European countries: PEPPs
- PEPPs back to back with existing local regimes
- Policy goals:
  - Stimulate multi-pillar diversification in pension provision
  - Stimulate consumer protection
  - Stimulate cross border activity by improved transparency and comparability

- Our paper analyzes the proposal, extends it and discusses potential impact in four countries: Netherlands, Estonia, Finland and Hungary

Analysis of PEPPs

- Products aim ‘to provide stable retirement income’
- Plea to restrict options to cash in retirement income prematurely
- But PEPP requirements relate to accumulation phase only
  - Decumulation as least as important ? Spend at day of retirement ?
  - Decumulation phase very different within Europe, e.g. UK vs NL
  - Decumulation phases to diverse to make progress (politics) ?

- Uniform restrictions on investment in accumulation
  - Limit number of choice options
  - Emphasis on life cycle ‘de-risking’ of equity risk
  - But no incentives to link investments to income targets (annuitized or not) and or to control conversion risk
  - De-risking nominal pension income implies deliberately taking interest rate risk

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Analysis of PEPPs

- Switching between products is restricted
  - Motivation given linked to investing in illiquid assets (Policy goal EU !)
  - Behavioral biases and transaction costs seem much more important reason to restrict frequent switching

- Clear support for internet sales
  - Can this provide adequate consumer protection ?

- Consumer protection rules linked to Key Information Document that is also used for pure investment products
  - Consumer protection is key, including transparency on fees
  - But too much emphasis on realized net returns if income target
  - Inform about all risks: too low contributions, (micro/macro)longevity risk, equity returns, interest risk, inflation risk. e.g using PPR

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Personal Pensions with Risk sharing (PPR)

E.g. macro longevity risk

Financial return

Biometric return

Other return drivers

Individual pension wealth previous period

Individual pension wealth next period

Withdrawal as income stream

Unbundle complex and rigid variable annuities

Unattractive characteristics of nominally guaranteed annuities triggered in UK farewell to annuities altogether

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Impact of insuring micro longevity risk

Impact of insuring micro longevity risk

Before passing someone passed away: 5 * 4 coins;
After person passed away: 4 * 5 coins;

Background: existing PPP rules Finland

- Role of Personal Pension Plans very small (tax treatment ?)
- Early withdrawal allowed special circumstances (e.g. long term unemployment, divorce)
- Life cycle investing strategies uncommon
- Short pay-out periods, no biometric returns, no annuity markets
- Currently quite hard to change providers

Background: existing PPP rules Estonia

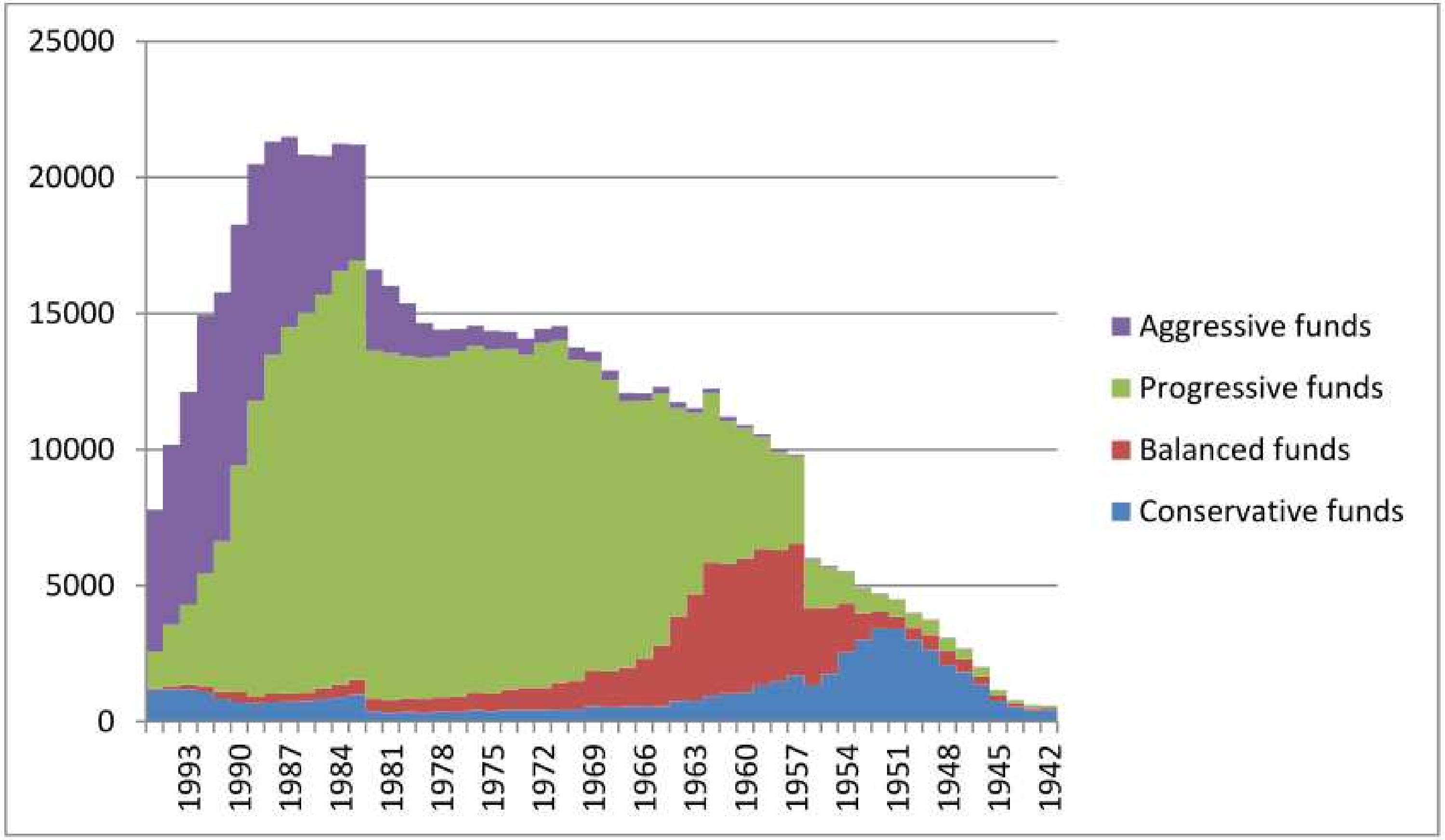
- No option to access the pension assets before the pensionable age
- Four different categories in asset allocations (conservative to aggressive), no automatic life cycling (but choices seem OK..)

- Investors can change providers up to three times per year (at a 1% cost)
- 15% change their contributions to another provider annually (50% in 2003 !)

- At retirement nominal guaranteed annuities to be obtained.
- Conversion can be postponed hoping for increased interest rates (= older Dutch products)
- Pensions inherited in cases of death for retirement age

Asset allocation choice in Estonia

Figure 1: People who have joined the compulsory funded pension scheme by investment strategy and birth year, 31.12.2014



Source: Riikliku vanaduspensioni..., Authors calculations

Background: existing PPP rules Hungary

- 1998 introduction of pre-funded privately managed system
- 12.5% of GDP in this system in 2011
- 2011 government intervention stimulated to give up funded reserves for restoration of accrual in PAYG pillar

- Pre-funded pension capital only 6.5% of GDP
- Four main forms, all dormant and underdeveloped
- These funds pay lump-sums only
- Nearly impossible to cash before retirement (high tax implications)
  - Apart from special purpose life-insurance, more than six years after paying in

Background: existing PPP rules Netherlands

- Usually life cycle investing in accumulation phase
- Currently decumulation based on nominal guarantees, annuitized
  - Within soon investment risk also in decumulation phase, but still annuitized
- Duty of care legislation of manage conversion risk between accumulation and decumulation phase (equity as well as interest rate risks)
- Hardly possible to switch from one provider to another, apart from start of decumulation phase

Conclusions

- Pension products and regulations are very different in different European countries
- PEPP rules attempt to harmonize and stimulate cross border transfers

- Consumer information on biometric risks (living long, disability etc.) and insurance are lacking in KIDs
- To what extent can one avoid national legislation for the decumulation by switching to PEPPs ?
- More attention required for decumulation phase and the implications of products characteristics there for adequate investment rules in accumulation phase

- Small step forward, at best.. Alternative: harmonize step by step…

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