

# Defined contribution default and other investment options



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## Table of content



- I. Introduction to the DC landscape in Europe
- II. Investment options and default in DC schemes
- III. Qualitative aspects
  - 1. Transparency and communication
  - 2. Monitoring and governance
- IV. Challenges and policy recommendations

2

## I. Introduction to the DC landscape in Europe

### I. Brief introduction to DC landscape in Europe

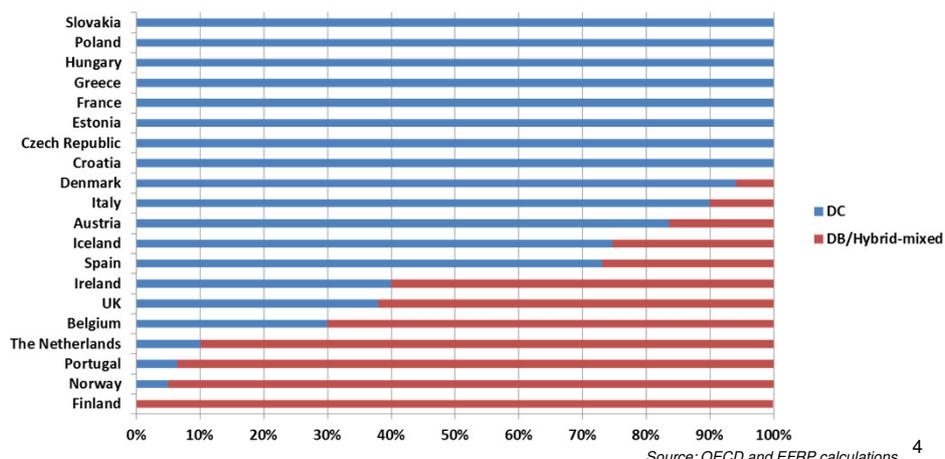


- Following presentation mainly based on EFRP Surveys with input from EFRP Members.
- EFRP Members represents more than EUR 1.5 trillion assets under management and more than 66 millions active plan members in DC schemes.

3

## I. Introduction to the DC landscape in Europe

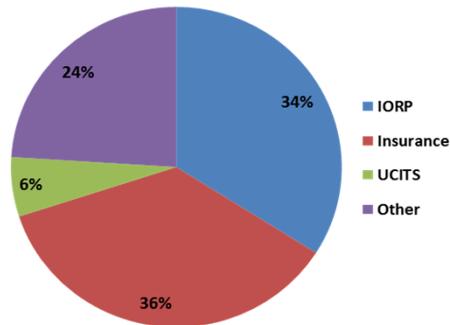
### 1. Relative share of DB and DC pension funds assets (2011)



4

## I. Introduction to the DC landscape in Europe

### 2. Administration of the DC pension plans



Source: EFRP surveys 2011-2012

(1) The category "Others" refers to vehicles subject to domestic regulation

5

## I. Introduction to the DC landscape in Europe

### 3. Growing importance of DC



- **Growing importance at both international and European level:**
  - DC pension funds assets in OECD countries increased from 30.3% to 35% between 2001 and 2011(OECD)
- DC schemes are **dominating in Eastern European Countries:**
  - Huge potential of increase due to the youth of the 2nd pillar pension systems in these countries.
- DB still dominate in countries with large occupational pension sector (UK, NL). However, there is a **shift away from DB:**
  - In UK for instance, only 16% of DB schemes are completely open while they were 31% in 2008.

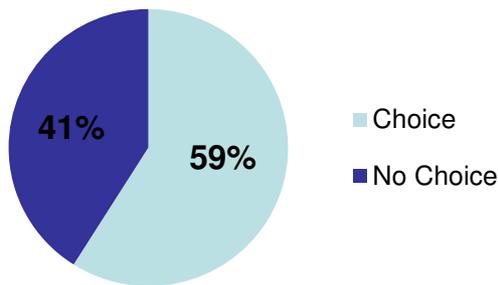
6

II. Investment options and defaults in DC Schemes

II. Investment options and defaults in DC schemes



Investment choice in mandatory/workplace DC schemes



Source: EFRP survey 2009

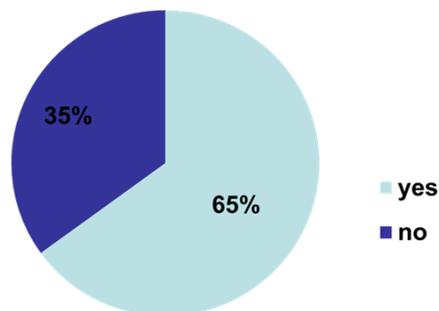
7

II. Investment options and defaults in DC Schemes

1. Are DC funds required to offer default fund?



Requirement to offer default investment fund to members

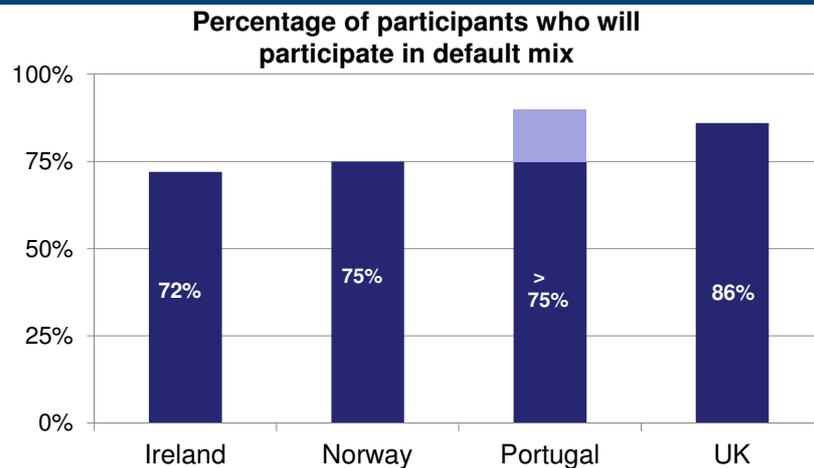


Source: EFRP Survey 2012

8

## II. Investment options and defaults in DC Schemes

### 2. The importance of defaults



9

## II. Investment options and defaults in DC Schemes

### 3. Behavioural finance: Why people often "choose not to choose"



- Default as endorsement  
→ People trust the default as best option
- Hyperbolic time discounting  
→ (Younger) People are not interested: pension is far away
- Limited financial literacy  
→ People do often not make a choice when something is complex

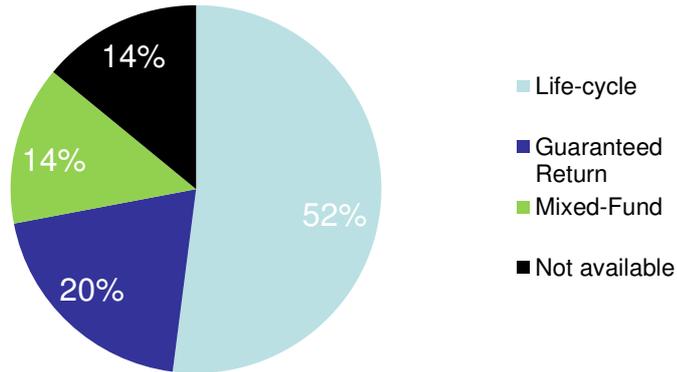
10

## II. Investment options and defaults in DC Schemes

### 4. Investment strategies default funds differ across Europe



Default fund in DC schemes with investment choice



Source: EFRP survey 2009

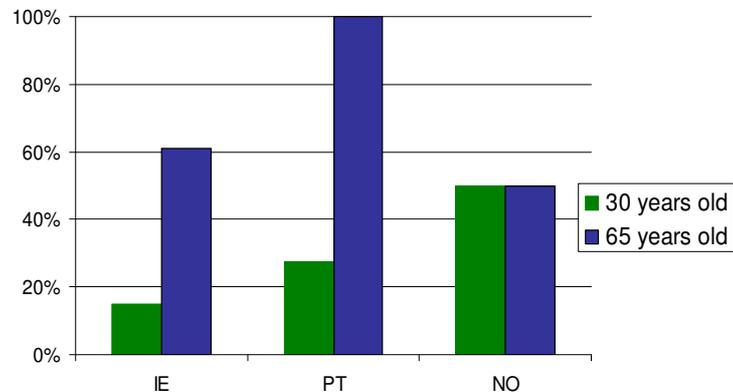
11

## II. Investment options and defaults in DC Schemes

### 5. Example: Different investment mixes in different Member States



DC investment strategy: investments in fixed income (%)



12

Source: EFRP survey 2012

## II. Investment options and defaults in DC Schemes

### 6. Reasons why DC investment mixes differ across Europe



6.1 First pillar pensions

6.2 Pay-out phase DC Pensions

6.3 Regulation

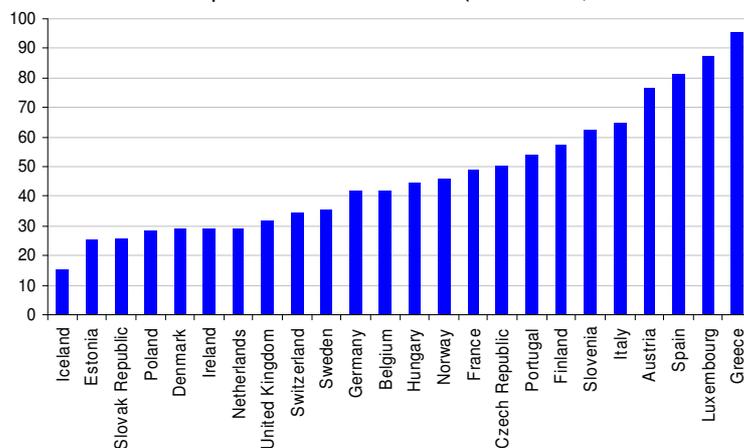
13

## II. Investment options and defaults in DC Schemes

### 6.1 First pillar pensions



Net Replacement Rate Public Pension (Median Earner)



14

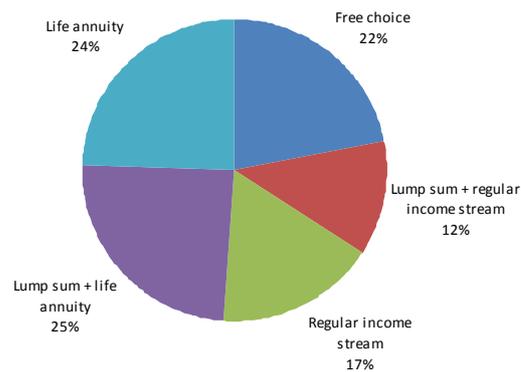
Source: OECD 2012

## II. Investment options and defaults in DC Schemes

### 6.2 Pay-out phase DC Pensions



- Regular income compulsory in 30% of DC plans, often besides partial lump sum
- Life annuity compulsory in 50% of DC plans, often besides partial lump sum



15

Source: EFRP survey 2011

## II. Investment options and defaults in DC Schemes

### 6.3 Regulation: mandatory guarantees in some Member States



- **Minimum return guarantees**
  - Austria
  - France (Article 83 group insurance)
  - Romania
  - Germany
  - Italy
  - Belgium
- **Minimum guarantee relative to the market average**
  - Bulgaria
  - Poland

16

### III. Qualitative aspects

## III. Qualitative aspects:

### 1. Transparency and communication



- Information to **members** about **investment options** when joining the pension plan:
  - All the DC schemes surveyed provide information through documents such as **Prospectus** (UK, FR, NO), **Statement of Investment Principles** (BE), **KIID** (FR), **mails** and **emails/website, meetings** and sessions (IE, PT)
  - The document must provide information on **investment choice**, structure of portfolio, **risk** exposure, **costs** of portfolio management and other costs related to asset management (Germany); forecast of the final amount that could be reached when retiring (Italy)

17

### III. Qualitative aspects

## 1. Transparency and communication /2



- **Information about the default option:**
  - By prospectus, mails, emails and similar documents in majority of countries.
  - No legal obligation in Germany
- **Should describe:**
  - Description of the default option available (UK, PT, IT etc.)
  - Overall objective of the default option according to risk profile
  - Disclosure of the charging structure (UK)

18

### III. Qualitative aspects

## 1. Transparency and communication/3



- **Examples of information on the performance of the (default) fund:**

- Should be done at least **annually** in a majority of countries. 3-4 times a year in Norway
- Through prospectus, mails, emails. Also available at any moment on website (France, Italy where each member has private account with password)
- Information must contain details on the **return/ performance** of the fund as well as **acquired capital**
- In Italy also information on the **benchmark returns**. The NAV for each investment option is also updated every month on the website.

19

### III. Qualitative aspects

## 1. Transparency and communication/4



- **Information on the costs (fees)**

- Pension funds in a majority of countries (except Norway) have to **provide information on costs to be borne by members and beneficiaries**
- Information to be provided on **costs of portfolio and asset management, administrative and financial fees**
- It is usually done when joining the scheme and whenever there is a change of costs. Also available at any time on website (Italy). Annual update in Ireland

20

## 2. Monitoring and Governance



- **Who determines the design of investment /default options?**

- The social partners (employees and/or employers) in 40% of schemes surveyed (France, Germany and Portugal for e.g.)
- 40% is determined by the provider of the DC scheme in Italy, the UK, Norway, Ireland etc.
- The trustees can also have the decision in the UK and Ireland

21

## 2. Monitoring and Governance /2



- **Monitoring of performance**

- The **members** monitor the performance in some schemes in BE, DE (where members are involved in the Supervisory Board), Ireland and in the UK
- The **trustees** (IE) or the **board of director** of the pension fund (BE, IT) and the social partners (NO) can also monitor the performance.
- In PT, the size of the scheme matters: For schemes with more than 100 members, a Monitoring Committee is mandatory. It monitors the implementation of investment policy of the scheme.

### III. Qualitative aspects

## 2. Monitoring and Governance /3



- **Adjustment of investment options:**
  - In the majority of countries, investment options are changed **less than once a year**
  - In Italy the asset allocation can be changed **whenever** on the basis of the market conditions
  - The Irish Regulator recommends the performance of default investment strategy should be reviewed **every three years**
  - The **main driver** for changing investment strategy is **market conditions** (realised returns or changing economic predictions)<sup>23</sup>

### IV. Challenges and policy recommendations

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- **Important challenges for DC:**
  - Achieving **good returns** despite low interest rates environment
  - Continue to cope with **guaranteed returns** in countries where it is imposed by law (Belgium, France etc.)
  - **Increase the coverage.** Auto-enrolment (UK, Ireland): Risk that it might lower the standard of DC provision
  - Upcoming legislation, conservative investment regulations.
  - Increase **consumer confidence** and continue to convince people of the advantages of collective savings compared with individual
  - How to provide **Long Term Capital** within DC schemes.

24

## IV. Challenges and policy recommendations /2



### • Future of investment choices and default investment mix

- The number of investment options is likely to **remain the same** in a majority of countries. In some countries it is likely to **rise** (UK & PT)
- The situation on investment mix of default funds is **heterogeneous**:
  - The asset mix of default funds is expected to change in the UK (more emphasis on alternative asset classes as infrastructures), in Norway (more equity exposure due to low interest rate environment). Irish default funds are likely to de-risk their investment mix
  - On the other side, no specific changes are expected in Italy or Portugal.

25

## IV. Challenges and policy recommendations /3



### • How helping participants to make an appropriate investment choice?

- Better **communication to members**
- Improve **financial literacy** and **financial education** at every level (school, universities, medias, companies).
- Tackle “**unequity**” **issue** in investment choice: All the participants are informed in the same manner regardless of their financial knowledge: Leads to non-optimal choices.
- **More information** from the insurance companies also. Not only prospects and e-mails, but information in a more **personal manner**, like meetings, telephone calls, etc.
- Could focus on **collective occupational pension systems** without or limited individual investment choice.



# Thank you!

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