RETIREMENT SAVINGS IN THE TIME OF COVID-19

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BETTER POLICIES FOR BETTER LIVES

What I am going to talk about

- The challenges facing retirement savings schemes as a result of COVID-19
- Main policies implemented
- The main OECD policy guidelines
- The main salient issues right now

Challenges: Several impacts on retirement

- COVID-19 and the economic lockdown have led multiple impacts on funded retirement arrangements and on retirement savings
  1. A fall in the value of **assets** comprising retirement portfolios
  2. An increase in the **liabilities** of retirement arrangements that include retirement income promises
  3. Lower **capability to contribute** to retirement saving plans from individuals, as they see their wages reduced or lose their jobs, and employers, suffering financial distress

Challenges: Several impacts on retirement

4. Individuals, regulators, supervisors and providers, are also expose to
   - Cyber-risk, frauds and scams
   - Operational disruptions as a result of working remotely
5. Countries have implemented measures aimed to improve people's situation and their retirement savings, providers and the pension system in general
   - Some countries have implemented measures to provide relief in the short-term that could have a negative impact in the long-term, especially on retirement income adequacy
6. Calls to use assets earmarked for retirement to support the economy (inc. recovery, sustainable and ESG investment)

Challenges and OECD policy guidelines

Challenges	OECD policy guidelines
Decrease value of assets in retirement savings accounts from falling financial markets	• **Stay the course: limit the materialisation of investment losses** (e.g. communicating consequences)
Increase liabilities from falling interest rates in retirement savings arrangements with promises	• **Secure the solvency of retirement plans and the business of providers** (e.g. lengthening recovery periods of DB plans failing to meet funding requirements)
Lower capability to contribute by individuals (job losses, lower wages) and employers	• **Stay the course: continue contributing** (subsidising contributions)
Operational disruptions, working remotely	• **Address operational disruptions** (e.g. improving online procedures, digitalization)
Cyber-attacks, frauds and scams	• **Protect from scams and cyber attacks** (e.g. warning plan members and giving them tips to avoid them)
Reduction savings and compound interest earned from policy measures to provide short-term relief	• **Access to retirement savings measure of last resort and based on individual specific (hardship) circumstances**
Call to use assets earmarked for retirement to support the economy	• ✓ By all means, safeguards in place to do it in the best interest of members and adequate investment vehicles

The value of the assets in retirement portfolios

- Covid-19 and the economic lockdown led to a sharp fall in the value of the asset comprising retirement portfolios
- The tendency is sell as soon as the value of the assets starts to fall. Unfortunately, this leads to materialising the loses. As long as the assets are not sold, loses are on paper
- In the event that markets recover, the losses could disappear in a large extend if not completely, as it occurred after the financial and economic crisis of 2008-2009
- Markets recovered proving the importance of stay the course and avoid materialisation of the losses

Guidelines

- Stay the course
- Avoid the materialisation of losses by selling
- Saving for retirement is for the long haul
- Investment strategies and retirement portfolios are designed to face markets ups and downs
- Avoid switching between funds and investment strategies that could lead to a materialisation of losses
- Shocks like COVID-19 and the lockdowns are temporal, although the economic impact may last longer, especially in certain economic sectors (e.g. restauration, travel, tourism)

Increase in liabilities, solvency problems

- The fall in interest rates (discount rate on liabilities) => pressure on the solvency of defined benefits retirement plans (retirement income promises) and insurance companies offering life annuity products
- Retirement income promises increase in value as discount rates fall, this coupled with the fall in the value of the assets, leads to worsening of solvency ratios (the percentage of liabilities that the current value of assets cover)

Guidelines

- Allow for more flexibility in recovery plans to address liability problems
- Funding and solvency rules for retirement plans with promises should be counter-cyclical => introduce flexible funding requirements to avoid pension funds act pro-cyclically, allowing them to act as long-term investors and potentially stabilizing forces within the financial system
- Important to reverse this flexibility once the exceptional circumstances have faded
- Supervision oversight should be proportionate, flexible and risk-based

Lower capability to save for retirement

- People that see their income fall or they lose their jobs cannot save for retirement and thus stop contributing to their retirement saving plans.
- Employers suffering financial distress as their business fall or stop altogether cannot contribute either
- The State may not have funds to continue matching contributions
- The solution could be to subsidise wages and contributions (e.g. furlough and especial unemployment programs)

Protecting pension providers and members from frauds and scams

- Increase of the risk of cyber attacks, fraud and scams through a variety of mechanisms (e.g. email, social networks, telephone calls to access personal information and savings)

Measures implemented

- Disclosure of the type of scams of the website of national authorities.
- Advice to the trustees and advisors to send regular and clear information to plan members as scammers may exploit misunderstandings and people's fears
- Dedicated webpage with FAQ or tips to help members deal with scams

Avoid measures for short-term relief but with potential long-term negative effects

- Covid-19 and the economic lockdown has led to job and employment loses, business loses and large reduction in income
- There is an obvious temptation to implement measures to provide relief against the short-term fall in income. However, certain measures can have a potential negative impact in the long-term, especially in the adequacy of retirement income
- Therefore, evaluate policy measures providing short-term relief in light of their potential long-term impact
- Measures like contribution holidays (exempt workers, self-employed and employers from contributing) or access (even if partial) to retirement savings

Long-term problems of short-term relief measures

- Contribution holidays lead to large reductions on accumulated retirement savings at the time of retiring. E.g., one year without contributing, an returning to previous level of contributions (without increases, policy inconsistent): 2-3 percentage points reduction
- Access to retirement saving pots would also lead to lower accumulated retirement savings and lower retirement income. The impact is larger the closer the individual is to retirement, if based on percentages (larger pots): 10% => 2-9% reduction
- Moreover, access to retirement savings have additional negative impacts
  - Pension funds may lack enough liquidity to face such surge in liquidity => sell assets and materialise temporary market loses
  - Pension funds may also need to undo long-term investment strategies

Guidelines

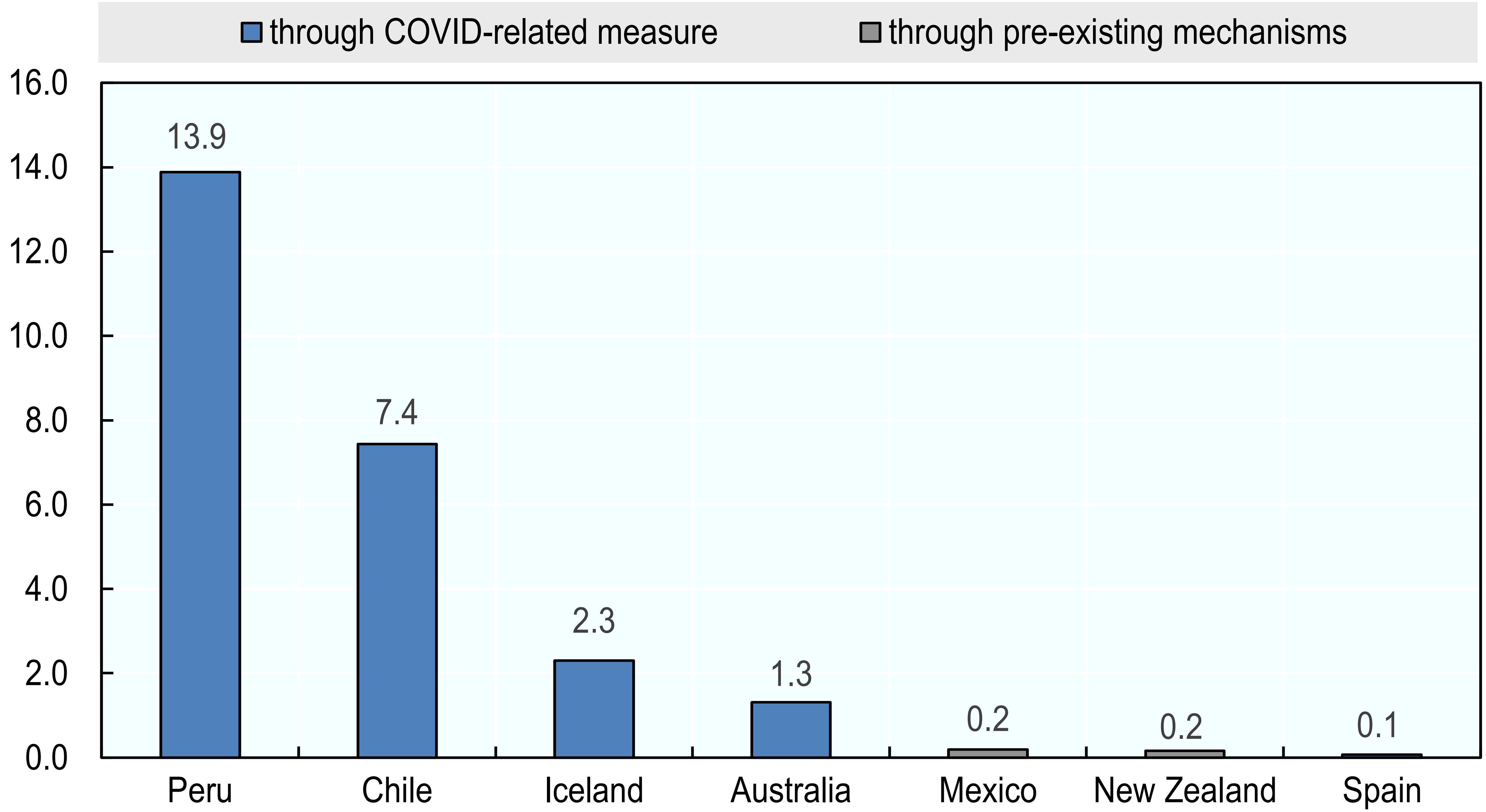
- Countries have other mechanisms to provide relief when income falls: state subsidies, (especial) unemployment (furlough) programs
- Certain countries may lack those mechanisms and enough resources. They should look for alternatives that avoid risking the future adequacy of retirement income
- Avoid measures that grant general access to retirement savings
- Accessing retirement savings leads to materialising temporary asset value loses, liquidity and investment problems for pension funds, and, more importantly, to adequacy shortfalls
- There are already, in the regulatory framework of many countries, stipulated conditions under which people suffering from certain exceptional circumstances, can have access to their retirement savings

Main message

- Accessing retirement savings should be a measure of last resort based on personal hardship circumstances.
- The discussion should be around what constitutes hardship
- Have legislation in place that allows access in exceptional circumstances and thus avoid in time of crisis legislating unconditional access

Early access to retirement savings is greater with lack of conditionality

Assets withdrawn early in 2020 (% of total assets end 2019)



Three salient items now

1. Have saving for rainy day (emergency savings).
2. Use assets earmarked for retirement to support the economy (e.g. the recovery and ESG investment opportunities)
3. The impact of COVID-19 on mortality and life expectancy

Emergency savings

- Savings for retirement are for the long-haul and should not be withdrawn earlier except in hardship personal circumstances clearly defined in the legislation
- Yet, COVID-19 have shown the need of emergency savings
- Some countries may have more than one saving account, one for health, one for emergency cases, and another one for retirement. The retirement one is locked for retirement while the emergency one can be used for exceptional circumstances and the balance left at retirement moved to the retirement account.
- However, if it is difficult to save for retirement, it may be more difficult to save for both retirement and emergency. If the current savings for retirement are not enough, splitting them into two accounts would make adequacy harder to achieve

Use of assets earmarked for retirement to support the economy

- Yes, of course, retirement savings should be use to invest in support of the economy, to help in the recovery, investing in sustainable and ESG investment opportunities
- But, only if
  - There are appropriate market structures and financing instruments
  - Suitable investment opportunities
  - Safeguards so providers act in the best interest of members
- Assets earmarked for retirement can be used as long as, those investment are made in the best interest of members (CP), which it is to reach a target retirement income and to invest to get the best return adjusted by risk and net of fees and charges

Use of assets earmarked for retirement to support the economy

- There should be safeguards
  - Independence of governing bodies
  - Members of those bodies fit and proper
  - Clear investment policies aligned with the main objectives, as well as adequate risk management processes
- It is essential that pension providers have available appropriate investment vehicles to channel their investments (PPP, infrastructure, Bonds, SMEs)

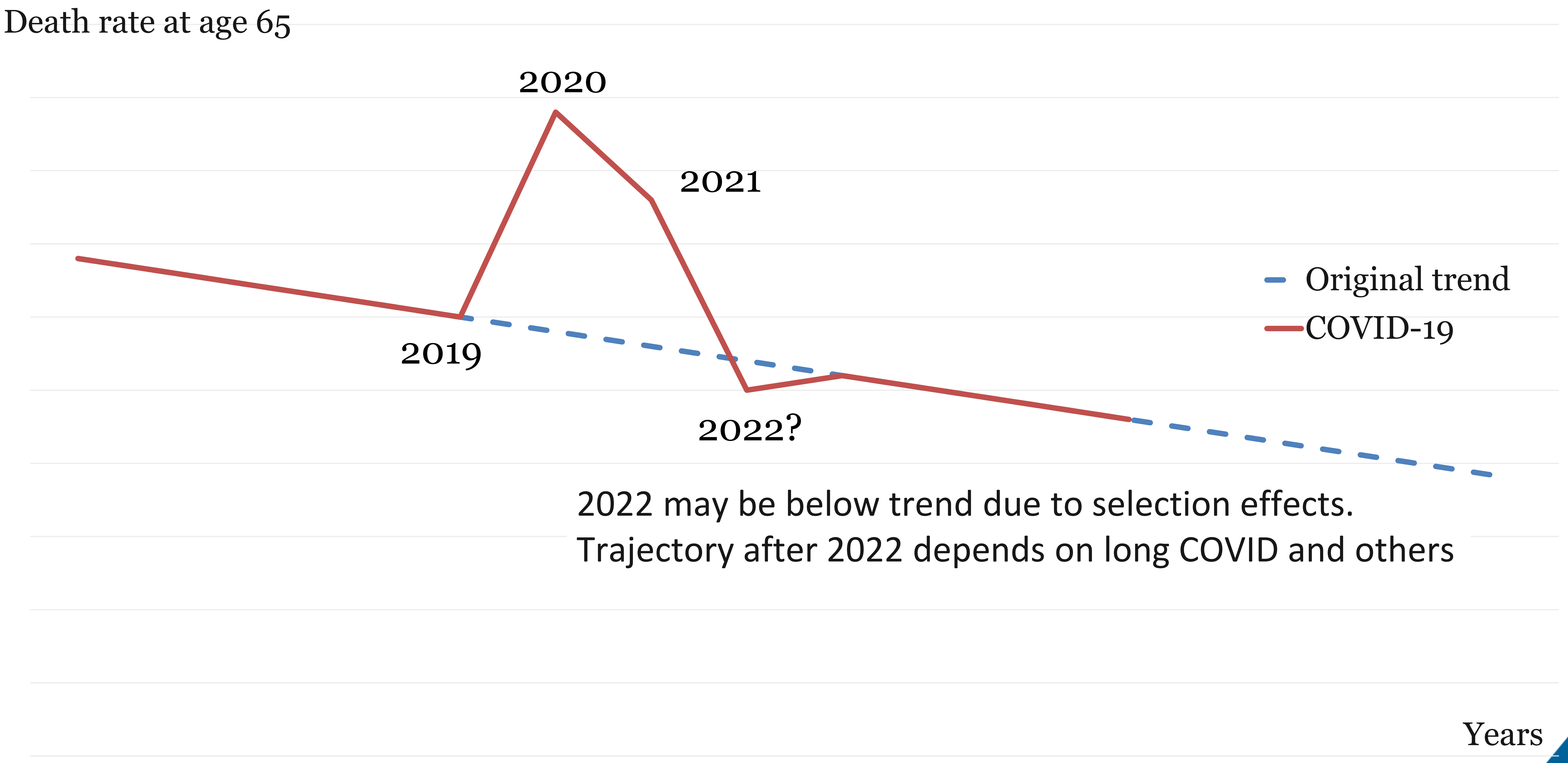
COVID-19 and mortality tables

- Regulators and supervisors use mortality tables to make sure that there is enough capital put aside to cover whatever retirement income promises exist (e.g. insurance companies)
- Life expectancy is an important variable to determine how much to save for retirement and for how long accumulated retirement savings need to last for
- Therefore, it is important to understand how COVID-19 may have affected or may affect mortality rates and life expectancy
- For this is important to distinguish between the short and medium term impact and the long-term impact on life expectancy and mortality rates

COVID-19 and mortality tables

- COVID-19 has affected the elderly more, so mortality rates for those 65+ (75+) have increased when measure against trend.
- Most of the people who have died from COVID-19 had previous conditions (comorbidities), therefore, they are people that had lower life expectancy to start with.
- They have died earlier than they would have died without COVID-19. People who were to die in, let's say, the next 3-5 years have died in 2019 and 2020. These are accelerated (or early) deaths
- Those left may have high life expectancy (bar long-term COVID)
- Once this window of 3-5 years disappear, life expectancy and mortality returns to previous trend.

Impact of COVID-19 on the death rate at a constant age by year with improvements



COVID-19 and mortality tables

- The long-term impact of COVID-19 on life expectancy and mortality is therefore quite negligible ➔ No need to change mortality tables
- Yes, institutions with pension promises will see their payments fall during the period of accelerated deaths, and thus profits increase in a few years. This is generally in their probability calculations, but most likely not up to such level.
- Average life expectancy will increase in the medium term as those that survive are those with higher life expectancy (those with lower life expectancy died earlier as a result of COVID-19)
- Reserving capital may not need to change as both effects may offset each other, and in the long-term life expectancy and mortality returns to previous trends.

Retirement savings in the time of COVID-19

- Responses to COVID-19 have touch us a lot on how to deal with shocks:
  - Stay the course: do not materialize losses by selling or switching (LT), keep contributing
  - Regulatory and supervisory flexibility (take it back afterwards)
  - Communication, information of cyber-attacks, frauds and scams
- Safety nets are quite important
- Early access to retirement savings should be a measure of last resort and only under personal hardship circumstances.
- Make sure that appropriate safeguards and vehicles exist for assets earmarked for retirement to support the economy, including ESG
- The long-term impact of COVID-19 on life expectancy and mortality is negligible. No need to change mortality tables. Monitor how mortality and life expectancy evolve

THANKS
Questions?

OECD work on pensions
www.oecd.org/insurance/private-pensions

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