SUMMARY:
Savings for Retirement and Role of Private Pensions in Retirement Readiness

CURRENT STATUS OF THE STUDY

The study is in the final stages of review. A final draft was presented on June 2nd to the Working Party on Private Pensions. The study will be finalized addressing the final comments received at the meeting and published by the OECD. It will be the basis for a chapter in the forthcoming OECD publication “Pensions in Focus” that is scheduled for December 2014.

BACKGROUND AND OBJECTIVES

The study is very ambitious in scope and was initiated in 2011 to assess the role that private pension system will play in providing retirement income now and in the future to assess the “retirement readiness” of future cohorts of retirees. It evaluates and projects retirement income sources for six OECD countries (Chile, France, Netherlands, Norway, The United Kingdom and The United States) a group that was selected based on the availability of data to support this kind of modeling and analysis.

It provides projections of the level and composition of retirement income for each country differentiating between public pension systems, defined benefit private systems (referred to as “based on rights”) and private defined contribution (“based on assets”). The study compares the projection of average benefit levels for each country to a country specific poverty level and an OECD definition of poverty that is 50% of the median income projected for the country. It then considers how inclusion of evaluating gender differences, public vs private sectors workers, different age cohorts and three income levels (low, medium and high) for each of the countries.
SUMMARY OF KEY FINDINGS AND POLICY RECOMMENDATIONS

Sources of Pension Income

The study documents differing distributions of anticipated sources of retirement income that are similar to other analyses, projecting as little as 5% of income on average from private sources in France to as high a proportion of 73% in Chile where the pension system was effectively privatized in the early 1980s although a public “social pension” to provide minimum income to retirees was reintroduced several years ago.

The most balanced system is projected for the United States with 64% of average income projected to be from public sources and 36% from private sources that includes 13% from employer sponsored DB plans and 23% from private DC plans (including IRAs). Among the three countries with mandatory private plans (Chile, Norway and the Netherlands) only Chile has a significantly higher share of income from private sources than the US and UK.

The study documents the well-known relationship between income levels and the share of pension income from private sources that is found to be most pronounced in the US, Netherlands and the UK, countries that have the longest history of private coverage.

Public sector workers in all of the countries are found to have greater private sources of retirement income. Gender differences are also found in most countries with men expected to have a greater share of income from private pensions except in Norway where women are far more likely to be employed in the public sector.

Younger workers are also found to have a greater potential private benefits in all countries reflecting recent expansions in coverage and benefit levels in all of the settings.

Poverty Alleviation

The proportion of individuals projected to receive pension benefits below the country specific poverty levels ranges from 37% in Chile to 1% in the Netherlands. The projection for the United States is 6%. These finding are significantly affected by differing methods of calculating the poverty line in each of the countries.

The projected portion of retirees receiving benefits below the poverty level increases to 19% for the US when the OECD’s definition of the poverty line (one half of median income) is used. The proportion of retirees with pensions below the poverty threshold in the European countries declines when this measure is used, indicating that their own definition is above this level. In all of the countries, except notably Chile, regardless of the definition, those below the poverty line are found to be nearly exclusively from the bottom third of the income distribution. The prevalence of below poverty level benefits
among all segments of the income distribution in Chile provides some potential commentary on the effect of the individual mandate and privatization experiment that is now 30 years in the making.

The projections find little change in the risk of pension income below the poverty level for later cohorts of retirees in most of the countries but project an increase in risk of low pension income for younger persons in the United States which is attributed to the increase in the age of full benefits from Social Security (while actual retirement remains at 65) and the shift form DB to DC plans.

**Income Replacement Rates**

The projections find a substantial projected income replacement rate for most of the countries with the exception of Chile. Retirees in the US are projected to replace on average 59% of final earnings and 78% of career average earnings with the results for the other countries ranging from 43% (Chile) to 79% (UK) of final earnings and 40% (Chile) and 114% (UK) of career average earnings.

Using 66% as a benchmark for final earnings replacement the study finds that despite the averages a high proportion of individuals in each country (ranging from 32% to 84% with 59% in the US) are anticipated not to achieve the benchmark. The projections indicate that higher income persons in all of the countries except Chile are less likely to achieve the benchmark replacement rate consistent with the design of most public pension system that provide declining relative replacement rates by income. Private sector workers and younger cohorts are found to be less likely to achieve the benchmark.

The projections show that depending on the country between 28% and 59% of future retirees will have lower pension income than current retirees.

**Impact of Housing Wealth**

The study uses a measure of imputed rent for the Netherlands, the UK and the US that is derived from housing wealth to provide a more extensive measure of retirement income replacement rate. This is found to represent 10% of retirement income in the US, 17% in the Netherlands and 19% in the UK. Adding this to other sources of income housing wealth is found to lower the risk on failing to achieve a benchmark replacement rate by about 10 percentage points.