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OF EUROPE

Perspectives on Defined Contribution Pensions in the EU

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What a member of a DC IORP needs to know to plan their retirement

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- What is a DC IORP?
 - Focus on IORPs where members can make choices regarding investment options and/or contribution levels
- What I'm not going to talk about
 - DB plans
 - Pensions Tracking Services
 - Digitalisation/AI/TikTok
 - Post retirement options
 - Duty of Care
- Fundamentals
- Review of the IORP II Directive
- Projections and assumptions



- Main variables pre-retirement
 - How much do I pay in?
 - How much can I afford?
 - What will I get when I retire?
 - Where should I invest it?
 - Term to retirement
 - Expected returns
 - Risk Tolerance
 - When do I plan to retire?
 - What information do I need to enable me to achieve my target retirement income?



- Article 36 provides that information provided to members (including the PBS) shall be
 - *written in a clear manner, using clear, succinct and comprehensible language, avoiding the use of jargon*
 - *presented in a way that is easy to read*
- Article 38 refers specifically to the PBS
 - *a concise document containing key information for each member*
 - *accurate, updated and made available to each memberthrough electronic means ... or on paper, at least annually*
- Article 39 sets out the key information which must be included - 8 “points” listed
 - Focus for this presentation on projections
 - *information on pension benefit projections ...and a disclaimer that those projections may differ from the final value of the benefits received. If the pension benefit projections are based on economic scenarios, that information shall also include a **best estimate scenario** and an **unfavourable scenario**.....*
- Article 40 sets out requirements in relation to supplementary information



- Article 38(5) states
- *Member States shall set out rules to determine the assumptions of the projections ... Those rules shall be applied by IORPs to determine, where relevant, the annual rate of nominal investment returns, the annual rate of inflation and the trend of future wages.*
- EIOPA survey indicates that a number of Member States have no, or very limited, “rules” in place
- Some countries have had assumptions determined centrally for some time e.g. Denmark, where an independent Council for Return Expectations was established in 2018 to set and review assumptions and Ireland, where assumptions for “Statements of Reasonable Projection” were determined by the Society of Actuaries in Ireland since 2009, and have been adopted by the Pensions Regulator since 2021.
- What assumption should be adopted for the “unfavourable scenario”? The (political) intention behind the inclusion of this requirement was to make clear to members that they were taking risks and things might turn out badly, so how best to illustrate this? For example, the Irish Pensions Regulator requires this projection to be undertaken using expected returns 1% p.a. lower than the “best estimate”.



- Article 62 of the Directive requires a five-year review of a number of aspects, including the functioning of the PBS.
- The EC Call for Advice reflected this and also noted the need to consider the information provided to members and beneficiaries in the light of the trend from DB to DC.
- EIOPA advice includes 35 pages related to the PBS, which contains an analysis of the current position, with the conclusion that the Directive does not adequately deal with information for DC IORP members
- The advice also refers to various EIOPA reports, including its 2018 *Report on the Pension Benefit Statement: Guidance and Principles based on current practices* and those relating to Pan European Personal Pensions (PEPP) and Pensions Tracking Services (PTS). Note also the sample PBS/PEPPBS which EIOPA have produced and are used in some MS.
- Highlighted issues in the reports are the need for comparability, design with a behavioural purpose, layering of information and easy-to-read layout.



*“Given the shift from DB to DC where members and beneficiaries will have increased financial responsibility and bear more risks, it becomes even more crucial to ensure the **clarity and comprehensiveness** of the information provided, and that it is provided at the right time and in the **right format**, so as **to enable members and beneficiaries to engage and make decisions that lead to good outcomes in the long run.**”*

*“Members and beneficiaries need to be able to understand the long-term implications of variable benefits and how their ultimate benefits relate to the premiums or contributions that they have paid in over the years. **They also need to understand the general relationship between the nature of financial risks and their pension benefits**, and all types of disclosures should **consider the financial literacy of the recipient.**”*



- Member States to specify the format of the PBS to ensure (domestic) comparability
- Specific reference to the level of risk borne by the member
- The information shall be layered and follow the principles of good design
- Information on sustainability – very short key information or a cross-reference to SFDR
- Information on return on investments over at least the past 12 months
- Information on investment selection including breakdown between options and risk level
- Show costs incurred in past 12 months, and estimate of impact on final capital
- Increase period for past performance figures from 5 years to 10
- Safeguards such as choice guidance to support the member when making choices.
- Include a favourable scenario
- Show benefits in real terms with short explanation
- Provide information on projection assumptions used



- Task Force developed a response which was considered by Pensions Committee and the AAE Board and was published in December 2004

<https://actuary.eu/wp-content/uploads/2024/12/AAE-Position-Paper-on-IORP-II.pdf>

- The AAE is generally supportive of the proposals relating to member communications in the EIOPA advice and looks forward to engaging in the ongoing process when the Commission issues a proposal for a Directive
- Some specific comments:
 - If we really want to make the PBS a success then it should provide an option for ‘call for action’ i.e. to encourage the member to consider whether they should make adjustments to their contribution rate or investment choices.
 - Layering of information is essential, and much of the information which might be included in the PBS should be made available by links to other sources.
 - Past performance information should carry caveats that past performance is not a guide to the future.
 - The AAE supports the principle of transparency to members and beneficiaries in relation to costs and charges but notes that it is important to assess the overall value-for-money offered.



- Focus seems to be on what “we” think members should know
 - Is this all necessary?
 - Sustainability?
 - Past performance?
 - Costs and charges?
 - “Nice to know” items should be available but not “front and centre”
 - *“Consider the financial literacy of the recipient”*
 - Have to have the same document for all members
 - Layering (digital format) with key information at front (“landing page”) with links to more information and greater detail for those who want/can understand it
 - Engaging presentation – pictures/graphs/social media



- Projection assumptions
 - Consistency between IORPs and also with other savings vehicles e.g. PRIIPs (assumptions set independently?)
 - Stability (don't change long term projections too often)
 - Risk sensitive (greater volatility of returns for risky assets)
- How to determine three scenarios - Stochastic/probabilistic or deterministic?
 - Deterministic – experts decide on 3 sets of assumptions using their skill and judgement
 - Stochastic – need to decide on models, inputs, confidence levels etc.
 - PEPP Regulation sets out in detail what must be done by providers, specifying the 15th , 50th and 85th percentiles as the scenarios (PEPP also has a stressed scenario set at 5th percentile)
 - Is this too complex and costly, and providing spurious accuracy?



- Best estimate/Unfavourable scenario/Favourable scenario
 - Need meaningful descriptions for members
 - EIOPA template uses “best estimation scenario”/ “bad weather” [rain] / “good weather” [sunshine]
 - PEPP uses “have medium success”/ “perform poorly”/ “perform very well”
 - Use pictures/graphs?
 - Interactive tools?
- (More) consumer testing needed?

Any questions?



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