



Fee Structure, Disclosure and Education

- Personal Pensions and DC Plans -

Russell Galer, OECD

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Structure of Presentation

1. Fees – Basic Parameters
2. Reasons For Regulatory Attention to Fees
3. Methods of “Regulating” Fees
4. Focus on Disclosure Rules
5. Role of Education and Advisory Services



Fees - Basic Parameters

1. One - time fee:
 - at purchase (“front end load”)
 - at sale/distribution (“back-end load”)
2. On-going, annual fees:
 - flat charges (e.g., administration fee)
 - asset-based (e.g., invest. mgmt. fee)
3. Other fees for various administrative and other services
4. Combination fee structures



Reasons for Regulatory Attention to Fees

1. Governmental responsibility for program effectiveness
2. Program failure implies increased governmental fiscal burden
3. High/unfair/deceptive/unreasonable/confusing fees and charges
 - Can lead to program evasion (mandatory) or low participation (voluntary)
 - Significantly erode returns
 - Unfairly erode value of smaller accounts



Reasons for Regulatory Attention to Fees (2)

4. Fees may reflect an expensive/inefficient program design
5. Fees can be confusing and difficult for purchasers to understand, assess and compare - leading to poor decisions
6. Depth of regulatory concern may vary with whether:
 - Mandatory or voluntary
 - Primary or supplemental
 - Degree of sophistication of participating individuals



Methods of “Regulating” Fees

- Program design efficiency and costs:
 1. Competition
 2. Economies of Scale
 3. Purchaser/Investor Bargaining Power
- Directly attend to the fees themselves
 4. Regulate Fee Amounts
 5. Enhance Transparency:
 - i. Regulate Fee Structure
 - ii. Disclosure



- Competition

1. Provide Individual Choice; facilitate ability to move accounts

But might:

- Increase marketing costs
- Lead to churning of account
- Result in numerous small accounts

2. Bid/Auction (Bolivia; US Federal Thrift Savings Program)

But might:

- Limit individual choice
- Be difficult to change vendor
- Result in politicised auction process

3. Lower Entry Costs

But might:

- Result in aggressive, costly marketing
- Be achieved by lowering appropriate regulatory standards



- Economies of Scale

1. Seek To Create Large Investment Pools
 - Use of 'mixed purpose' pools (US IRA accounts and 401(k) assets in retail mutual funds)
 - Limit number of managers (Bolivia)
2. Centralise Administrative Functions
3. Minimise Number of Small Accounts; Transactions
 - Limit access of part-timers/low wage earners to earnings based schemes
 - But might: - Have policy/ political implications
 - Enhance persistency of accounts with a given fund
 - But might: - Be contrary to facilitation of individual choice and competition



Does Scale Impact on Fee Levels?

- In theory, yes.
 - But difficult to assess:
 - Does one measure “Costs” or “Charges”?
 - Evidence from US mutual funds generally suggests yes for “costs” and “fees”.
 - Evidence from Australian Superannuation Funds suggests yes for administration costs.
 - Evidence from UK and Latin America suggests no relationship between “Charges” and fund size.
 - Large employers contracting for 401(k)s in the US get a better deal per employee.
 - Fixed costs can be spread over more employees
 - Larger employers may be more sophisticated; have greater bargaining power
 - But: larger asset pools generate larger asset-based fees, so costs may be shifted



- Purchaser Bargaining Power

- Governments and employers may be in a better position to bargain with financial institutions
- Individuals tend to be insensitive to price/fees
- But with respect to employers:
 - Need to address 'agency' problems: Bargaining entity should bear the costs, not shift them
 - Reliance on employer as intermediary gives rise to new host of supervisory issues



Direct Regulation of Fees

Fee Amounts: Ceilings on charge rates

- But low charge ceilings may discourage provider entry and lead to a very limited individual portfolio choice

Fee Structure: Simplifying structure increases transparency for consumers, eases comparability

- But:
 - Choice of structure may unevenly impact on the population
 - Different fee structures are beneficial to differently situated individuals
 - Changes nature of revenue flow to providers



Focus on Disclosure Rules

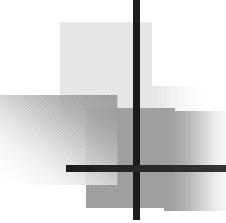


Purpose and Goals of Disclosure:

- Achieve greater transparency of the program/product
- Provide purchasers uniform basis of comparison, where there is choice
- Be appropriate for the relevant audience
- Assist the supervisor

Disclosure: Considerations For Regulators

1. *To whom:* Employers; Members
2. *By whom:* Fund or plan
Financial Intermediary
Administrative Service Provider
Sales Agents
Employer
3. *How -- Method of Delivery:*
Written document or oral disclosures
By post, by hand or by e-mail?
Receipt verification? (signature?)



Disclosure: Considerations For Regulators (2)

4. *When - Timing and Frequency:*

At inception of the relationship/entry into plan?

Prior to initial investment?

Sufficient time to read and consider?

Once, annually, or upon material change?

Automatically or upon request of individual

Disclosure: Considerations For Regulators (3)

5. *Content of Disclosure Document:*

Fees: Standardised Comparisons of rates?

Estimated cash value to be charged on an investment?

Breakout of fee types and associated services?

E.g. Asset management; service fees; commissions

Other related items: Historical Performance Data, etc.

Role for Annual or Quarterly Reports/Statements

6. *Supervising Rule Compliance and Disclosure Practices*



The Role of Education & Advisory Services

- Even the best disclosure practices can be insufficient
 - Individuals/Employers do not review
 - Subsections of population will remain overwhelmed
 - Financial illiteracy
 - Consumer insensitivity to fees
 - Other matters tend to rate as more important in purchase/investment decision
 - Seemingly de minimis fees may significantly erode returns and account values over time
 - Individual Passivity



The Education Process

- Who are the appropriate players in the process?
 - Government/Employers/Product providers/Other third party intermediaries
- Who bears the costs?
- What are the liabilities?
- How do you regulate and supervise? (conflicts of interest; suitability; method of delivery; etc.)
- Education or Advice
- How does one address the resolutely passive portion of the population?