

# Consumer Protection and Governance: The Role of Disclosure

**(Room Document 19,  
Session 4)**

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Disclaimer: All implicit or explicit views here are personal views and not necessarily those of Watson Wyatt.



# **Does Disclosure Work**

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- For consumer protection, probably not.
- For development of institutional investments, probably.



# **History of Disclosure in the UK**

- 1988-1995: Weak disclosure rules
- 1995-2001: Hard disclosure rules
- Sept. 1998: Stakeholder pensions paper
- Spring 1999: FSA guidance
- From 2001: Cost regulation



# Costs

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Reduction in Yield = Benchmark Yield -  
Yield with Charges

## Prospective Data from UK Regulator (PIA Survey):

### Effect of Charges on Personal Pensions (1998)

	£60pm	£200 pm
RIY after 5 years	14.4%	11.5%
RIY at maturity	1.9%	1.4%

Average personal pension is about £100 p.m., PIA:  
60% in force after 4 years from company reps, 70%  
IFAs.



# Costs

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## 3As of Consumer Costs

**Accumulation** - charges during accumulation stage, no change in plan

**Alteration** - charges for alteration of plan

- varying premium
- changing provider - transfers vs. paid-up

## Annuitisation

**In UK, alteration costs have been important. Relevant whenever there are front-loaded insurance contracts.**



# Provider Costs

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## 3As of Provider Costs

**Acquisition** - commissions, advertising, etc.

**Administration** - policy maintenance costs, IT, etc.

**Asset Management** - costs of fund management

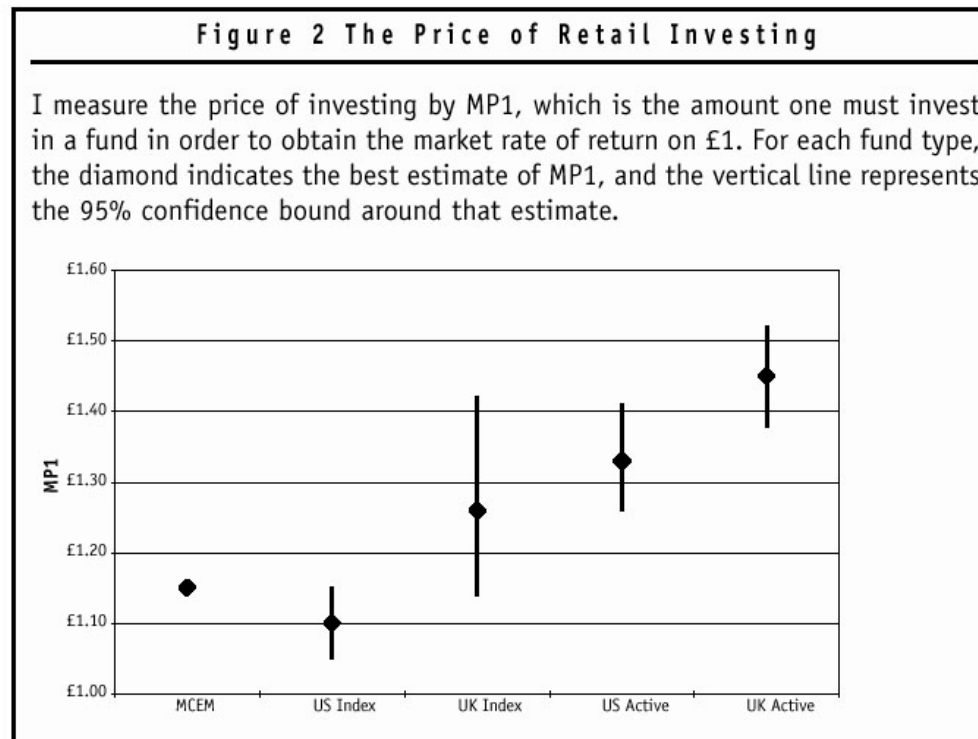
**In the UK, acquisition costs were traditionally about 60% of total costs. Asset management costs are only 10-15%.**



# Costs

Kevin James, Price of Retail Investing in UK, FSA, Feb. 2000

MP1 = Benchmark Yield/Yield with Charges



Life  
offices:

benchmark  
9.56%

fund 5.95%

MP1 = 1.6



# Did it work?

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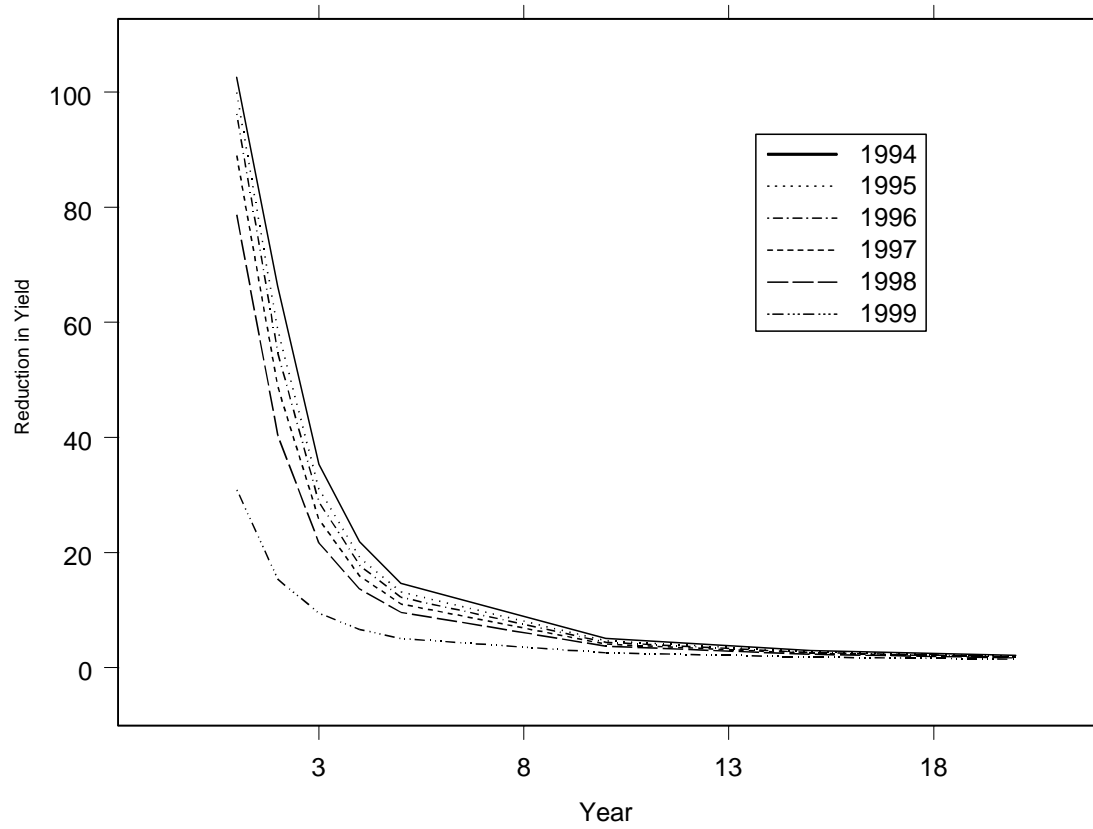
Year	Average annual management fees (basis points)	Charge ratio (assuming 40-year career)
1989	149.2	0.29
1990	151.4	0.29
1991	152.6	0.29
1992	155.6	0.30
1993	148.7	0.29
1994	147.1	0.28
1995	137.8	0.27
1996	131.1	0.26
1997	127.9	0.25
1998	124.0	0.25
1999	118.0	0.24
2000	116	0.23





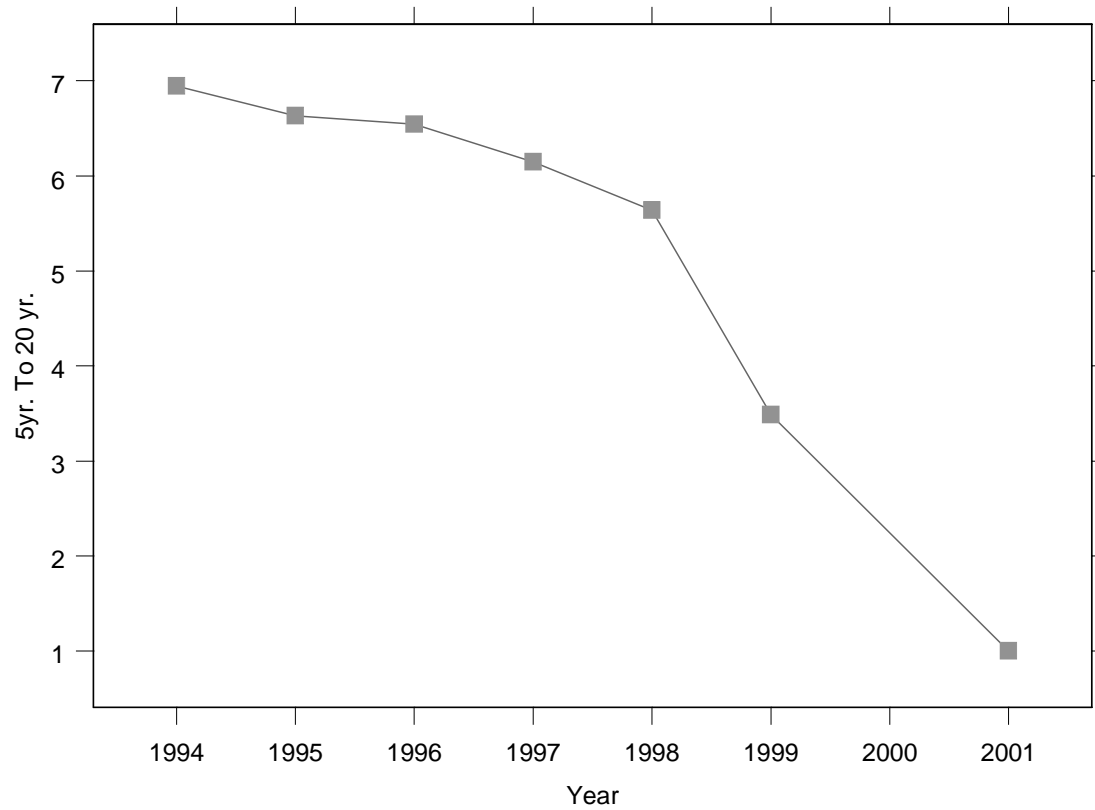
# Did it work?

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# Did it work?

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# **Disclosure of Status**

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- Marketing regulation – Polarisation
- Introduced with Financial Services Act of 1986
- Intended to protect customers by strict status disclosure: tied or independent



## **Did it Work?**

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- Did not prevent misselling scandal?
- Direct and independent channels had roughly the same costs.
- Socioeconomic segmentation of market.



## **Disclosure: Consumer protection**

- All else equal disclosure is nice.
- There is not much evidence it leads to better market outcomes.
- Economic theory is ambiguous on effects.



## **Disclosure: Institutional Investors**

- Investors pay attention: example of FRS17 in the UK.



# General approach

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## UK - FRS17

- No smoothing
- No spreading
- Prescribed valuation method

## Comparisons

- FAS87 – smoothing and spreading
- IAS19 – less smoothing than FAS87



# Discount rate

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## UK - FRS17

- Market yield on a AA corporate bond of similar duration and currency as liabilities

## Comparisons:

- IAS19/FAS87: Yield on high quality corporate bond





# **Recent Developments**

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- Rapid movement towards closure of final salary schemes.
- Attention to risks and size liabilities due to FRS17 is perceived to be a key factor.



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