

Regulatory challenges of DC plans: OECD Principles and Guidelines

“OECD-IOPS Conference on Private Pensions in Asia”

Bangkok, 28 April 2005

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A shifting paradigm of private pension provision

OLD	NEW
Final salary DB	Hybrid and DC
Early retirement	Flexible retirement age
Regular contributions	Irregular careers
Employer as guarantor	Employer as facilitator

The challenges of DC plans: an economist's diagnosis

- People's attitude to risk and time is not always rational (consistent)
- Severe informational asymmetries
- There is uncertainty, as well as risk

The facts

- Many members do not exercise choice (e.g. 30% in Sweden in 2000 / 90% of new members, 80% in Singapore, 75% in Argentina) or make inconsistent/inadequate choices (e.g. 401(k))
- Choice of provider is much less sensitive to cost of product than to marketing / sales effort
- Nearly impossible for members to gauge future relative performance of providers

The solutions

I. The **libertarian** solution:

- Better disclosure (e.g. comparable fees, investment performance, etc), financial education programmes and independent financial advisors

II. The **libertarian paternalistic** solution:

- Limit range of choices (e.g. 5 in US Gov TSP, 5 in Chile)

III. The **paternalistic** solution

- Cap fees (e.g. UK stakeholder, Irish PRA, Poland OPE, Swedish PPS) and provide a guaranteed product (e.g. Belgian and German DC plans, most provident funds)

The remaining challenges

- Who selects range of investment choices and providers?
- How to design the default option for those who do not choose?
- How low should fees be set?



Who should choose investment options?

- Government/regulator?
- Employer?
- Plan trustee/fiduciary?
- Provider?

The **default** option: a tale of two Swedish funds

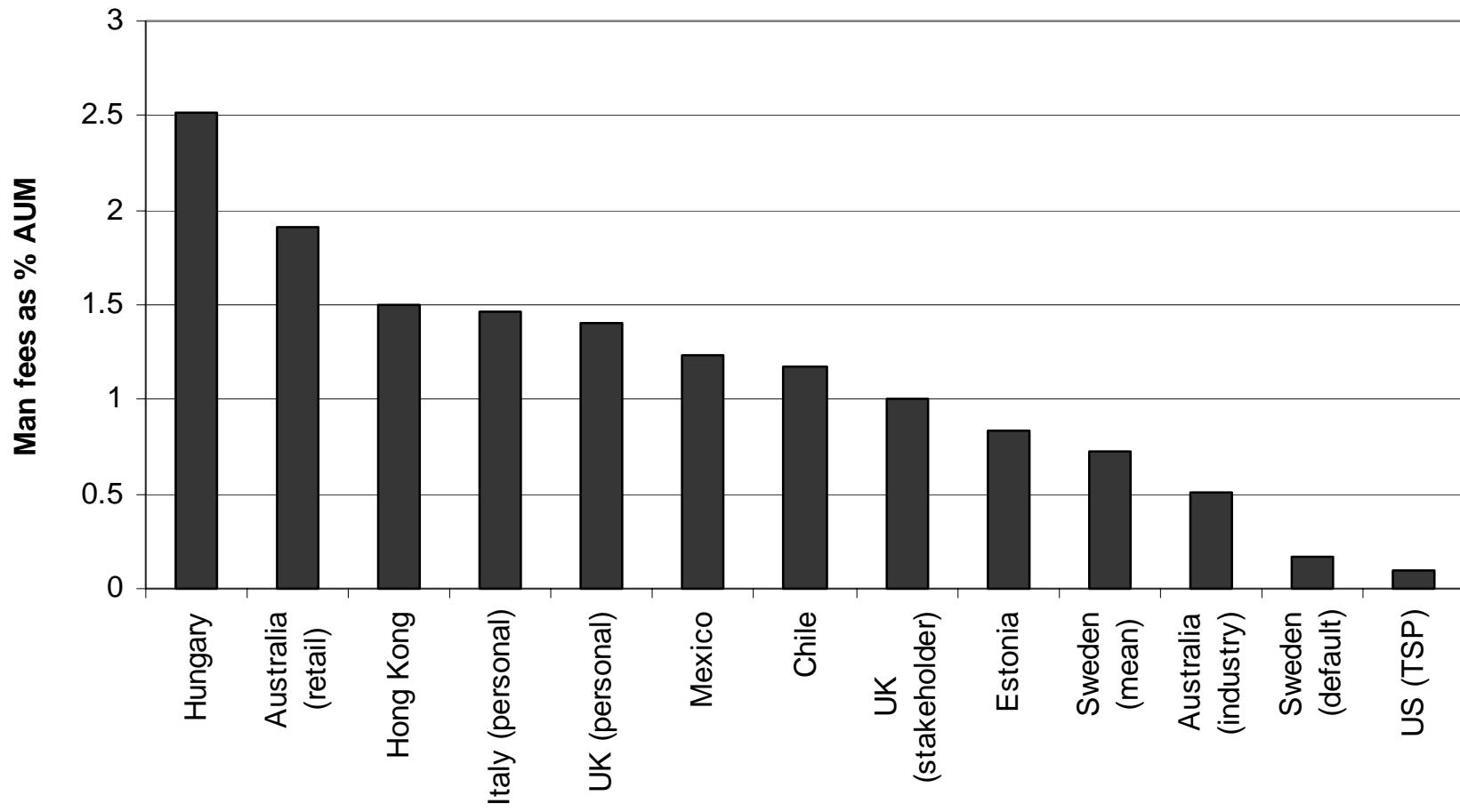
Portfolio characteristic	<i>Percentages</i>	
	Default	Mean active portfolio
Equities	82	96.2
Sweden	17	48.2
Americas	35	23.1
Europe	20	18.2
Asia	10	6.7
Fixed-income securities	10	3.8
Hedge funds	4	0
Private equity	4	0
Indexed assets	60	4.1
Fee	0.17	0.77
Beta	0.98	1.01
Rate of return (2000-3)	-29.9	-39.6

Source: Cronqvist and Thaler (2004)

A tale of two cities: the **default** fund

SWEDEN PPS	HUNGARY VPS
80-90 % equities	80-90% Hung. state bonds
Max 75% foreign equities	0-15% foreign securities

Fees are lowest in centrally managed funds





By way of conclusion

- I. A small number of easily understood choices is better for consumers than many poorly understood choices.
- II. Default options should presume conservative investors (a deferred real annuity?)
- III. A high degree of concentration in account and (possibly) asset management is inevitable in order to keep costs low