SUPERVISING DC PENSION SYSTEMS

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Difference DB /DC Supervision

- Inherent risks are the same in DB/ DC pensions…

… who bears them is the key difference

- Individuals are responsible for DC risks …

…but their understanding is low…

… which is the problem that lies behind all DC issues

- Transparency is therefore the 1st control mechanism…

…but low levels of understanding means that it can only partially work

- Other control mechanism are therefore needed…

…which to use depends on the nature of the pension system

Transparency and Education Mechanisms

- Information disclosure requirements
  - OECD guidelines
  - IAIS stress ***how*** as well as what disclosed important
  - Some countries prescribe precise format of documents (Chile, Italy, Mexico, Slovakia)
  - Others how information should be disclosed (e.g. net of charges/ frequency of reporting / risk or volatility as well as returns)
  - Some authorities approve key documents prior to publication (Bulgaria, Hong Kong, Slovakia)
  - Some check for compliance after (e.g. Turkey)
- Supervisors themselves can provide comparative information (e.g. Chile, Hong Kong)
- Others play a role in educating members (e.g. Ireland)

DC Specific Risks

- Investment Risk
  - Risk-management systems
  - Risk limitation measures
  - Target outcomes
- Cost Control
- Operational Risk
- Accumulation to Decumulation Phase

Investment Risk Control
Risk-management Systems

- Risk-management systems
  - Some supervisory authorities lay out detailed requirements (e.g. Mexico)
  - Others more general guidance (e.g. UK, Australia)
  - OECD guidance
    - Management Oversight & Culture
    - Strategy & Risk Assessment
    - Control Systems
    - Information, Reporting & Communication

- Statement of Investment Principles is a key part of risk-management
  - OECD guidance

Investment Risk Control
Risk Limitation Measures

- Quantitative Investment Limits

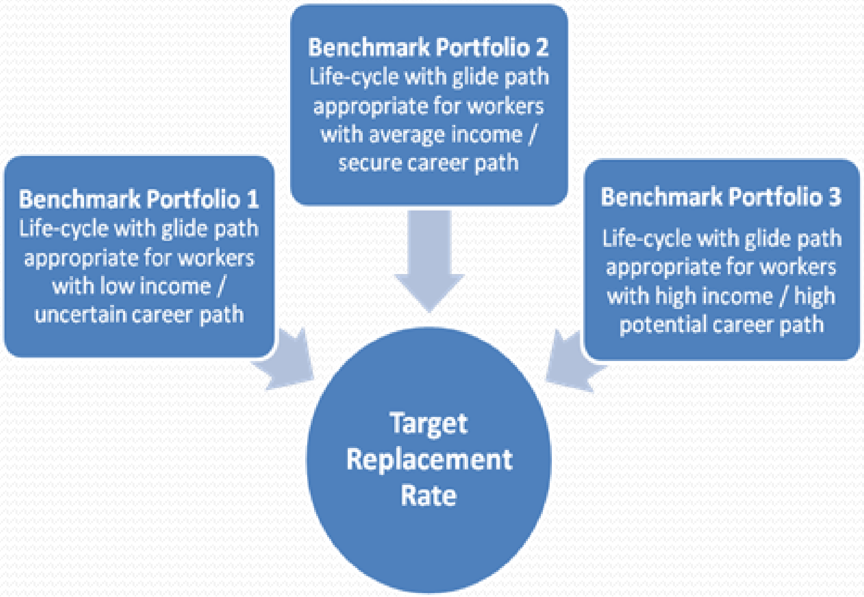
- Life-cycle Funds

- Risk limits (VaR)

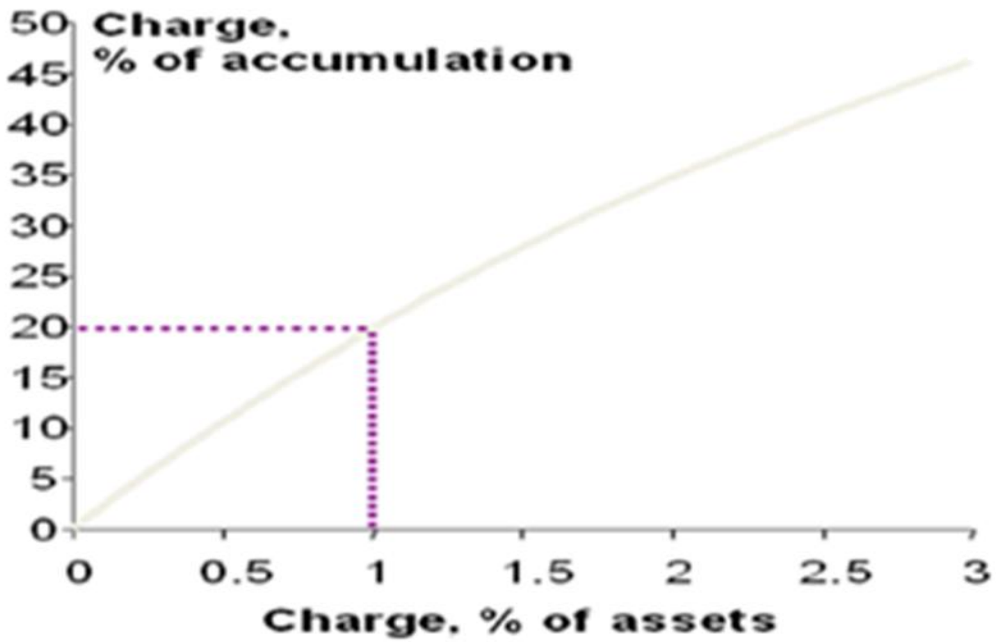
Investment Risk Control
Target Outcomes

- Guarantees
  - Absolute (e.g. Belgium, mandatory funds Romania)
  - Relative (e.g. Poland)

- Replacement Rate Targets



Cost Control



Source: Whitehouse, E.R. (2001), "Administrative charges for funded pensions: comparison and assessment of 13 countries", in OECD, Private Pension Systems: Administrative Costs and Reforms, Private Pensions Series, Paris

Cost Control

- Improve Transparency
  - Specified structure (e.g. Italy, Mexico)
  - Supervisory authority comparisons (e.g. Hong Kong, Spain)
- Fee Caps (e.g. Israel, Eastern Europe, UK stakeholder fund)
- Not unreasonable test (e.g. New Zealand, USA)
- Control mechanisms
  - Allocate members to lowest cost provider (e.g. Chile)
  - Restrict switching (e.g. Colombia, Bulgaria, Estonia)
  - License low cost providers (e.g. Macedonia, Bolivia)
  - Centralized/ collective services (e.g. Poland, Mexico)

Operational Risk Control

- Operational risks require focus in different countries:
  - Fund transfers (Israel)
  - Record keeping (UK)
  - IT (Nigeria)
  - Data integrity (Australia)
  - Conflicts of interest with providers (Chile)
  - Contribution collection (Hong Kong)

- Risk management systems at pension funds 1st line of defence

- Outsourcing risk particular issue for DC funds
  - Pension supervisory authority may oversee contractors…
  - Or coordinate with other authorities…
  - Or require pension fund to check the systems of their contractors

Accumulation to Decumulation Phase

- Require certain type of product (indexed life annuity)
- Timing risk via flexibility when purchase
- Assistance chose between types of product or annuity

Supervisory Tools

- Nature of the pension system determines choice of control mechanism
- Control mechanisms used determine supervisory approach