

Comments on policy recommendations in “Evaluating the financial performance of pension funds”

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Motivation for the project

- Wide diversity in pension systems in the world
- Likewise huge heterogeneity in participants in these pension systems
- A lot of scope for analysis to find the optimal pension system for a country (or participant)
- Financial performance is one of the determinants of a good pension system

Core design issue for pension schemes

- Financial performance
 - Asset allocation and level of risk taking
 - Manager performance
 - Age dependency in asset allocation
- Level and flexibility in contribution rates
 - Level of contributions most important determinant
 - Individuals should be willing and able to continue their contributions, possibly through insurance (labor income risks)
 - Scheme should have mechanism to absorb risk, e.g. increase in contribution rates

Core design issue for pension schemes II

- Cost levels
 - 1% annual cost difference has impact of 40% on pension income
 - Mandatory elements reduce costs substantially because marketing efforts are avoided
- Transparency
- Choice options and defaults
- Decumulation of pension wealth
 - Advantage of annuities: commitment device; insures against longevity risk
 - Disadvantage of annuities: irreversibility, often lack of adequate (real, variable) annuities

Performance measurement

- Traditional measures of financial performance such as Sharpe ratios measure only one aspect of the relevant issue
- In principle a welfare based analysis is far superior
 - Measures relative wealth loss or gain due to design of pension system
 - Requires number of assumptions on determinants of welfare, individual behaviour, institutions etc.
- In principle this enables a traffic light system as advocated which indicates how all design issues add up
- In the Netherlands such a traffic light system is in place for the (indexation in the) decumulation phase

Policy recommendations

- Encourage good coverage
- Encourage adequate defaults for enrollment, contribution rates, asset allocation, decumulation, ..
- Make pension systems cost effective
- Encourage adequate decumulation of pension wealth
- Encourage transparency on costs, risks and benefits
- Make sure that promises are kept
 - Solvency legislation if guarantees have been given
 - Specify “soft” rights and honor them
- Consider the possibility to develop international standards through the use of a traffic light system