Does Disclosure Work?
Mike Orszag

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

• Probably Not
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

Reduction in Yield = Benchmark Yield - Yield with Charges

Prospective Data from UK Regulator (PIA Survey):


<table>
<thead>
<tr>
<th></th>
<th>£60pm</th>
<th>£200 pm</th>
</tr>
</thead>
<tbody>
<tr>
<td>RIY after 5 years</td>
<td>14.4%</td>
<td>11.5%</td>
</tr>
<tr>
<td>RIY at maturity</td>
<td>1.9%</td>
<td>1.4%</td>
</tr>
</tbody>
</table>

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

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

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

Figure 2 The Price of Retail Investing

I measure the price of investing by MP1, which is the amount one must invest in a fund in order to obtain the market rate of return on £1. For each fund type, the diamond indicates the best estimate of MP1, and the vertical line represents the 95% confidence bound around that estimate.

Life offices:
benchmark 9.56%
fund 5.95%
MP1 = 1.6
## Did it work?

<table>
<thead>
<tr>
<th>Year</th>
<th>Average annual management fees (basis points)</th>
<th>Charge ratio (assuming 40-year career)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>149.2</td>
<td>0.29</td>
</tr>
<tr>
<td>1990</td>
<td>151.4</td>
<td>0.29</td>
</tr>
<tr>
<td>1991</td>
<td>152.6</td>
<td>0.29</td>
</tr>
<tr>
<td>1992</td>
<td>155.6</td>
<td>0.30</td>
</tr>
<tr>
<td>1993</td>
<td>148.7</td>
<td>0.29</td>
</tr>
<tr>
<td>1994</td>
<td>147.1</td>
<td>0.28</td>
</tr>
<tr>
<td>1995</td>
<td>137.8</td>
<td>0.27</td>
</tr>
<tr>
<td>1996</td>
<td>131.1</td>
<td>0.26</td>
</tr>
<tr>
<td>1997</td>
<td>127.9</td>
<td>0.25</td>
</tr>
<tr>
<td>1998</td>
<td>124.0</td>
<td>0.25</td>
</tr>
<tr>
<td>1999</td>
<td>118.0</td>
<td>0.24</td>
</tr>
<tr>
<td>2000</td>
<td>116</td>
<td>0.23</td>
</tr>
</tbody>
</table>
Did it work?

![Diagram showing reduction in yield from 1994 to 1999. The graph plots the reduction in yield against the year, with each year having a distinct line. The lines show a decrease in yield over time.]
Did it work?
Disclosure of Status

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

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

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