Market structure, scale, expertize and governance as drivers of costs and investment outcomes

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Costs and investment impact the efficiency of a pension system - one of the 5 critical outcomes that determine overall performance

Efficiency

- World leading pensions have total cost under 0.5% or 50bps of assets under management a year, second tier 0.5% to 1%, third tier 1% to 2% and the most expensive systems cost over 2%.
- Returns on average in the worst funds can be negative or zero, while the best give 4% real pa
- By 2050 a 0.5% point difference in annual growth achieved through good policy would be worth $85bn a year.

Sustain ability

- Achieving sustainable public finances and politics requires tackling the challenges from longevity and low interest rates and returns. Target would be to reduce the combined total of explicit and implicit debt (unfunded pension obligations on government balance sheet. As a reference implicit debt in key EU countries ranges from 163% to 293% of GDP.

Coverage

- Increasing coverage from 20% to even 50% globally would cover hundreds of millions of workers. Specific target for increase in coverage would be country specific and linked to the type of intervention – for example if only a voluntary private pension introduced coverage target would have to be modest – around an extra 10% point. Mandatory/auto-enrolment reforms can target much higher percentages – depending on degree of labor market informality – from 30% to 80%.

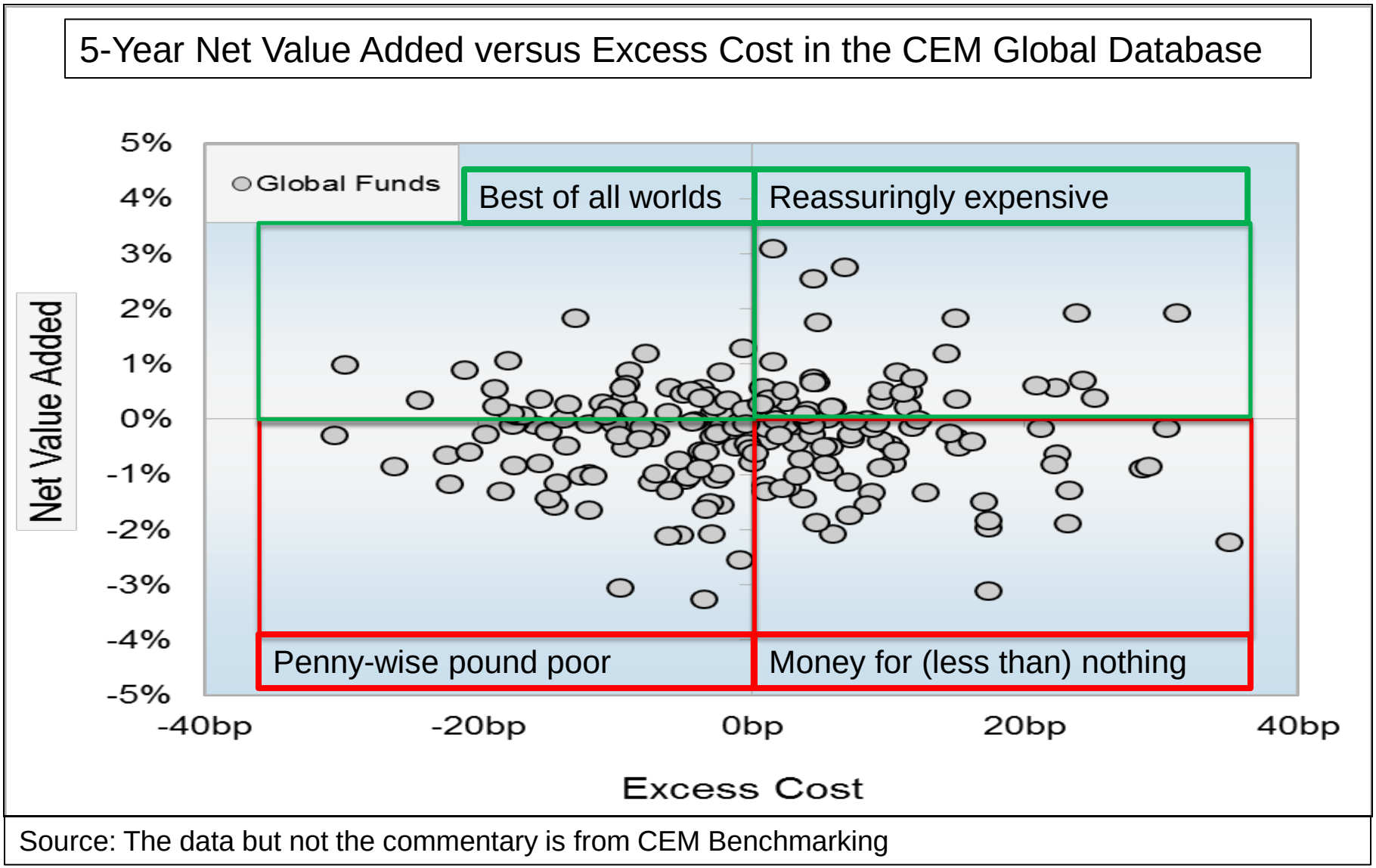
Adequacy

- Core adequacy – increase in % of people with income above the poverty line.
- Broad adequacy – increase in incomes of bottom 40% of population (to align with new World Bank global targets on eradicating poverty and boosting shared prosperity.
- In both cases target broken down by gender (and other relevant groups e.g. region) to focus on improving equity.

Security

- Annuities and other retirement products can protect against falling back into poverty and impact of volatility – so outcome would be increased % of individuals with secure retirement income
- Automatic adjustments to risks can be built into the system – with retirement ages rising with longevity and investment allocations changing with age to reduce the impact of instability and encourage long-term investment players in the capital market.

Lower costs not always better value – but nor are higher costs. Need to focus on clear added value – and understand political dimension

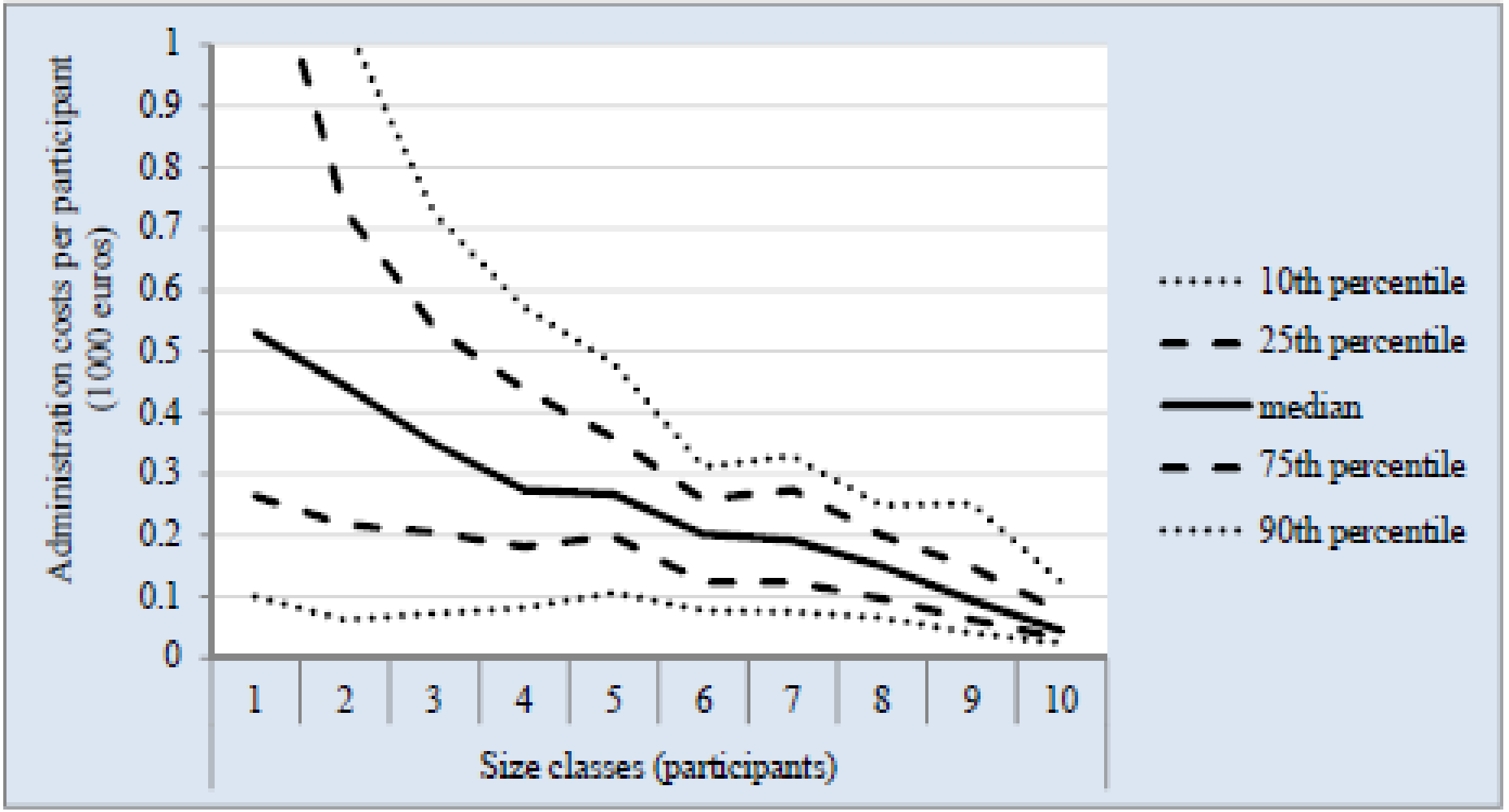


Source: The data but not the commentary is from CEM Benchmarking

Costs and investments are best tackled by country specific solutions built after reviewing the main pension outcome drivers

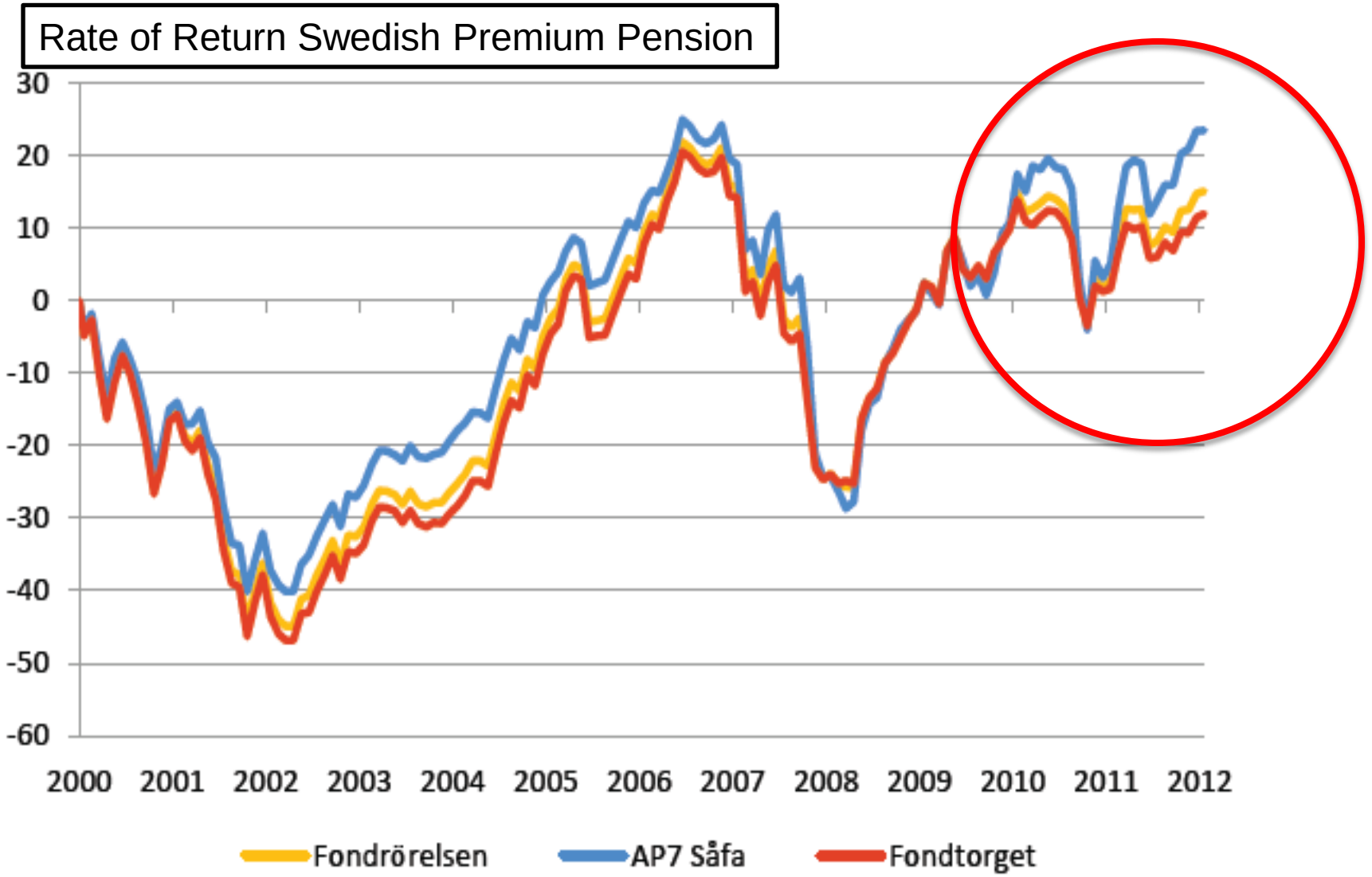
Drivers of costs and investment	Examples from each part of the pension system that impact cost/investment performance
Economic and political environment	• Number of members and assets • Development of local capital market • Political climate and public and private governance
Overall Framework – other pillars and key rules	• Governance arrangements and LR objective • Fee caps or fee control mechanisms • Overall system design
Market Structure, Entities and Governance	• Vertically integrated PFMCs • Sales agent distribution model or more direct • Split between account and investment management and between external and in-house
Supervision	• Availability of clear, transparent data • Focus on governance and value for members • Allocation mechanism and default funds

Large scale economies exist (particularly in administration) but lower costs do not mean lower fees without a strong demand side



Source: Bikker (2013) 'Is there an optimal pension fund size: A scale economy analysis of administrative and investment costs; DNB Working Paper 376. Participants in each size class are up to 280, 525, 850, 1,300,1,900,3,000, 5000, 11,000 and 35,000

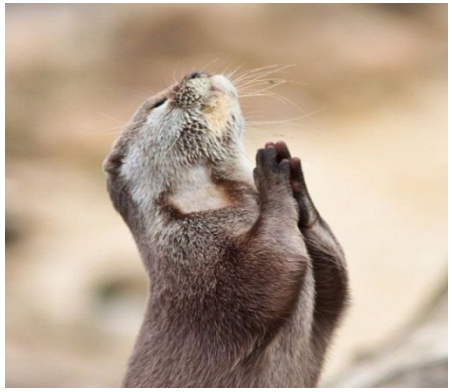
The benefits need to be judged over long time periods and with transparent and comparable data – which is often not available



Expertize, scale, good design and solving the ‘distribution’ issue is essential to make demand and supply work for members

DEMAND → SUPPLY

FROM



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A range of case studies help to illustrate some of the key messages

- Chile and Peru and the impact of auctions
- UK – ‘NEST’ (National Employment Saving Trust)
- Kosovo Pension Saving Trust
- Sweden
- Thrift Saving Plan
- The potential benefits of the Provident Fund model

The best outcomes appear when all elements targeted

DEMAND		DISTRIBUTION and SUPPLY			COSTS
Who decides strategy, chooses provider and negotiates costs?		*How demand and supply are matched*	*Administration and investment management*		*Costs*
Individual		Sales Agents	Admin and Inv Management in PFMC		High: some LAC/ECA
Individual	Default member allocation rule	Agents AFTER initial allocation	Admin and Inv Management in PFMC		Med e.g. Mexico
Individual	Auction	Agents AFTER initial allocation	Admin and Inv Management in PFMC		Med e.g. Chile
> Member-focused governance > Expertise > Scale > Bulk purchases for members > Default funds > (Or experience of high net worth well advised)		Member automatically added (via employer)	Admin – competitive bulk tender	Investment Management - competitive bulk tenders	Low and Med inc 'NEST' UK model and Kosovo
		Member automatically added (via employer)	Admin competitive bulk tender or in-house Use of tax system	Investment Management – in-house provision & external choice or external with high passive allocation	Low – e.g. Swedish PPM/ large occ. Plans
		Member automatically added (via employer)			Low – e.g. ATP, TSP/ Malaysia EPF?

*Fee caps can be used in any model but any positive impact will depend on good design. Note table shows ways to improve costs and investment, not all possible ways to deliver pensions.