

# Paying for pensions

Administrative charges, individual choices and institutional structures

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Oaxaca, Mexico, May 2006

# Agenda

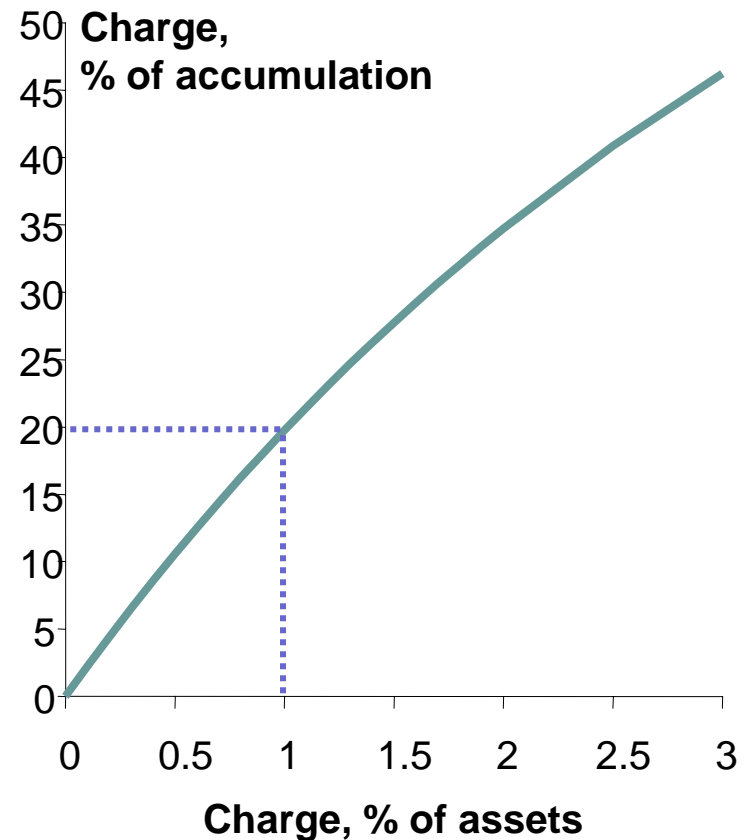
- Measuring charges for private pensions: How do charge levels compare? What have the trends been?
- Which different approaches have countries adopted to try and keep charges low?
- How do institutional structures and the degree of individual choice affect charges?
- Evidence from OECD countries, Latin America and Eastern Europe

# Measuring charges

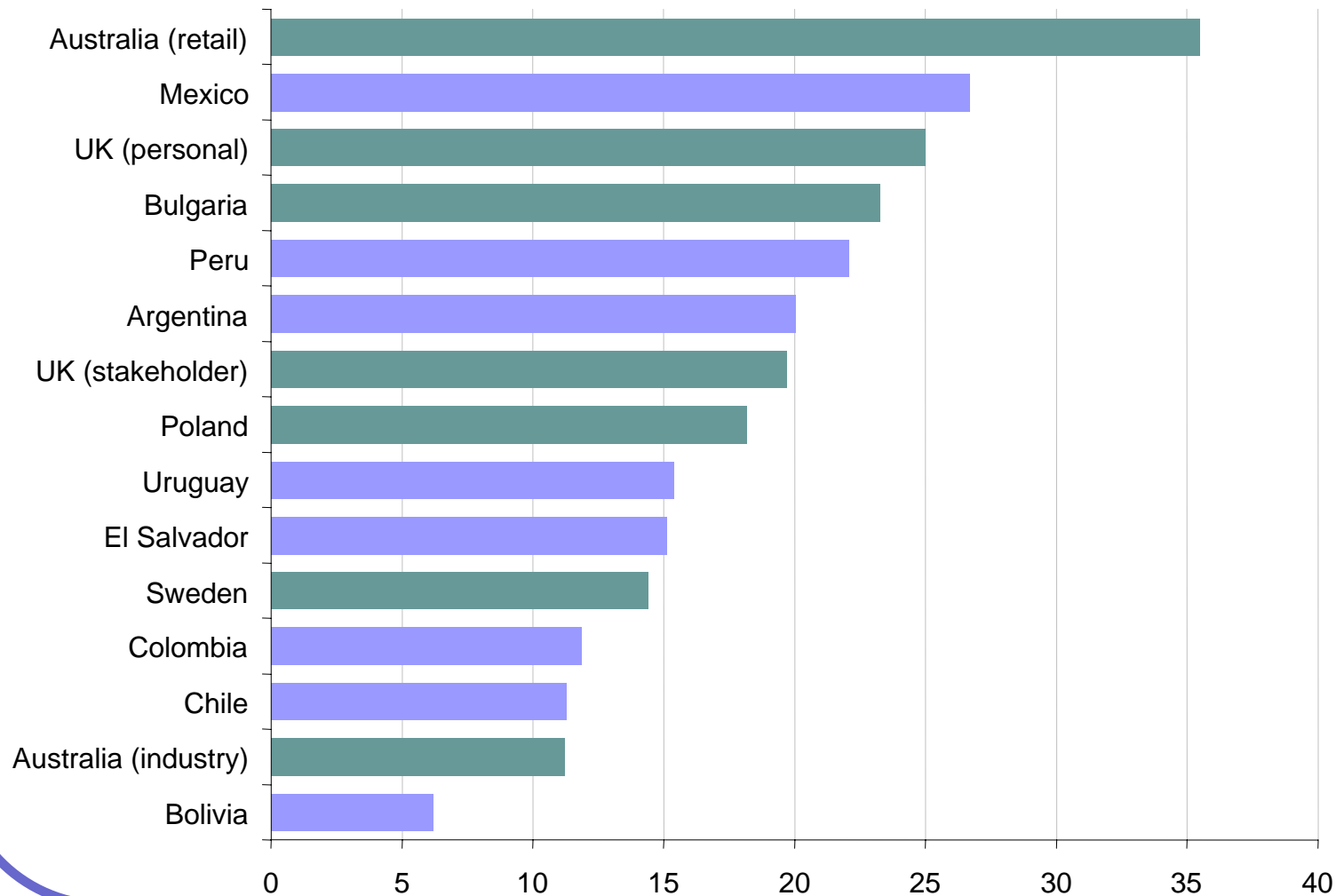
- Complex charge structures
  - comparisons are difficult both between countries and between providers
- A single measure of charges:
  - **charge ratio**: proportion of accumulated balance
  - **reduction in yield**: proportion of assets in fund at any one time
- Illustration: assume 3.5% real return, 2% wage growth and 40 year term

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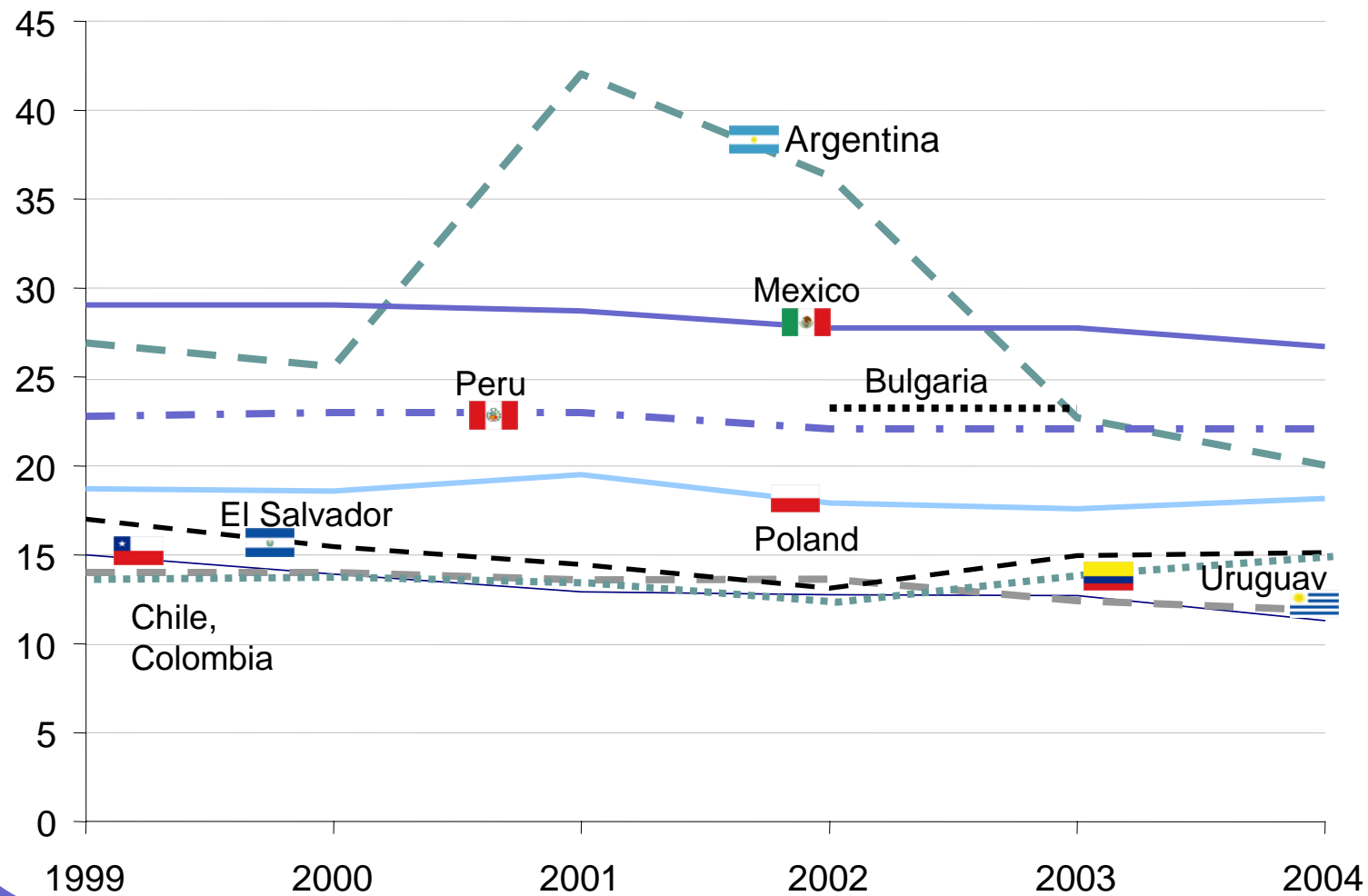


# Charge ratios

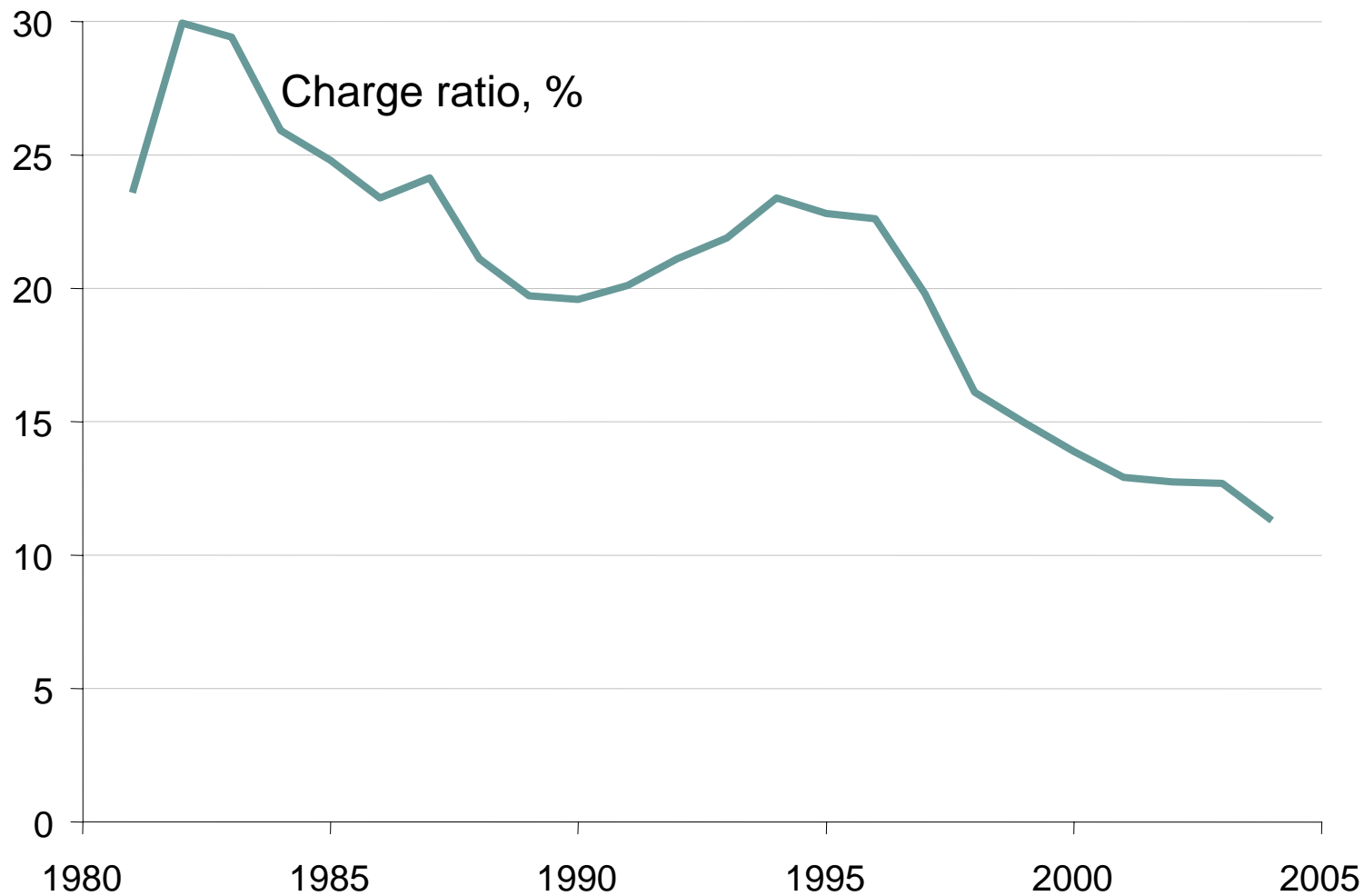


Source: FIAP,  
OECD

# Trends in charges: Latin America



# Long-term trends in charges: Chile



# Policies on charges: indirect measures

- **Disclosure:**
  - standard format
  - league tables
  - public information
- **Incentives:**
  - person who bears the charge should choose the provider
  - levy charges on top of contributions
- **Transparency:**
  - a single 'price' for pensions
- **Restrict ability to switch providers:**
  - might reduce marketing costs





# Policies on charges: direct measures

- Ceilings on charges:
  - El Salvador, Kazakhstan, Poland, Sweden, UK (*stakeholder*)
- Subsidies to low-income workers:
  - Mexico
- Force switchers to choose lower cost funds:
  - Mexico
- Subsidise charges:
  - New Zealand (*KiwiSaver*)
- Cross-subsidise charges:
  - Sweden
- Different institutional and structural approaches

# Individual choices








	<i>Portfolio no</i>	<i>Portfolio limited</i>	<i>Portfolio yes</i>
<i>Provider no</i>			
<i>Provider limited</i>			
<i>Provider yes</i>			

# Individual choices










	<i>Portfolio no</i>	<i>Portfolio limited</i>	<i>Portfolio yes</i>
<i>Provider no</i>	 Denmark  Hong Kong  Ireland (OP)  Switzerland		
<i>Provider limited</i>			
<i>Provider yes</i>			

- Employer manages fund internally or chooses external manager
- Single portfolio
- Denmark: SP and ATP schemes managed centrally

# Individual choices

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<i>Provider no</i>	<ul style="list-style-type: none"> <li> Denmark</li> <li> Hong Kong</li> <li> Ireland (OP)</li> <li> Switzerland</li> </ul>		
<i>Provider limited</i>		<div style="border: 1px solid black; padding: 10px; display: inline-block;"> <p>□ Sweden's mandatory DC plan and voluntary schemes in UK and US offer huge range of choices</p> </div>	
<i>Provider yes</i>			<ul style="list-style-type: none"> <li> Sweden</li> <li> United Kingdom (<i>personal, stakeholder</i>)</li> <li> United States (<i>IRA, Keogh</i>)</li> </ul>

# Individual choices

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<i>Provider limited</i>		<div style="border: 1px solid black; padding: 10px; width: fit-content; margin: 0 auto;"> <p>□ Australia introduced choice of provider in 2005, which also extended investment choices</p> </div>	
<i>Provider yes</i>			<ul style="list-style-type: none"> <li> Australia (<i>2005 on; until 2005 for retail funds</i>)</li> <li> Sweden</li> <li> United Kingdom (<i>personal, stakeholder</i>)</li> <li> United States (<i>IRA, Keogh</i>)</li> </ul>

# Investment choice: Australia

	% of assets with choice	average choices
□ Corporate	73.9	4
□ Industry	98.0	7
□ Public sector	56.5	6
□ Retail	88.1	59
□ Total	85.3	23





















# Individual choices


	<i>Portfolio no</i>	<i>Portfolio limited</i>	<i>Portfolio yes</i>
<i>Provider no</i>	Denmark Hong Kong Ireland (OP) Switzerland	Australia ( <i>members of corporate, industry, public-sector funds until 2005</i> ) United States ( <i>TIAA/CREF, TSP</i> )	Singapore United States (401k)
<i>Provider limited</i>	<div style="border: 1px solid black; padding: 10px; margin: 10px 0;"> <ul style="list-style-type: none"> <li>□ Schemes for public-sector workers in US have limited menu</li> <li>□ 401k plans have expanded investment choices</li> </ul> </div>		
<i>Provider yes</i>			

# Investment choice: 401k plans

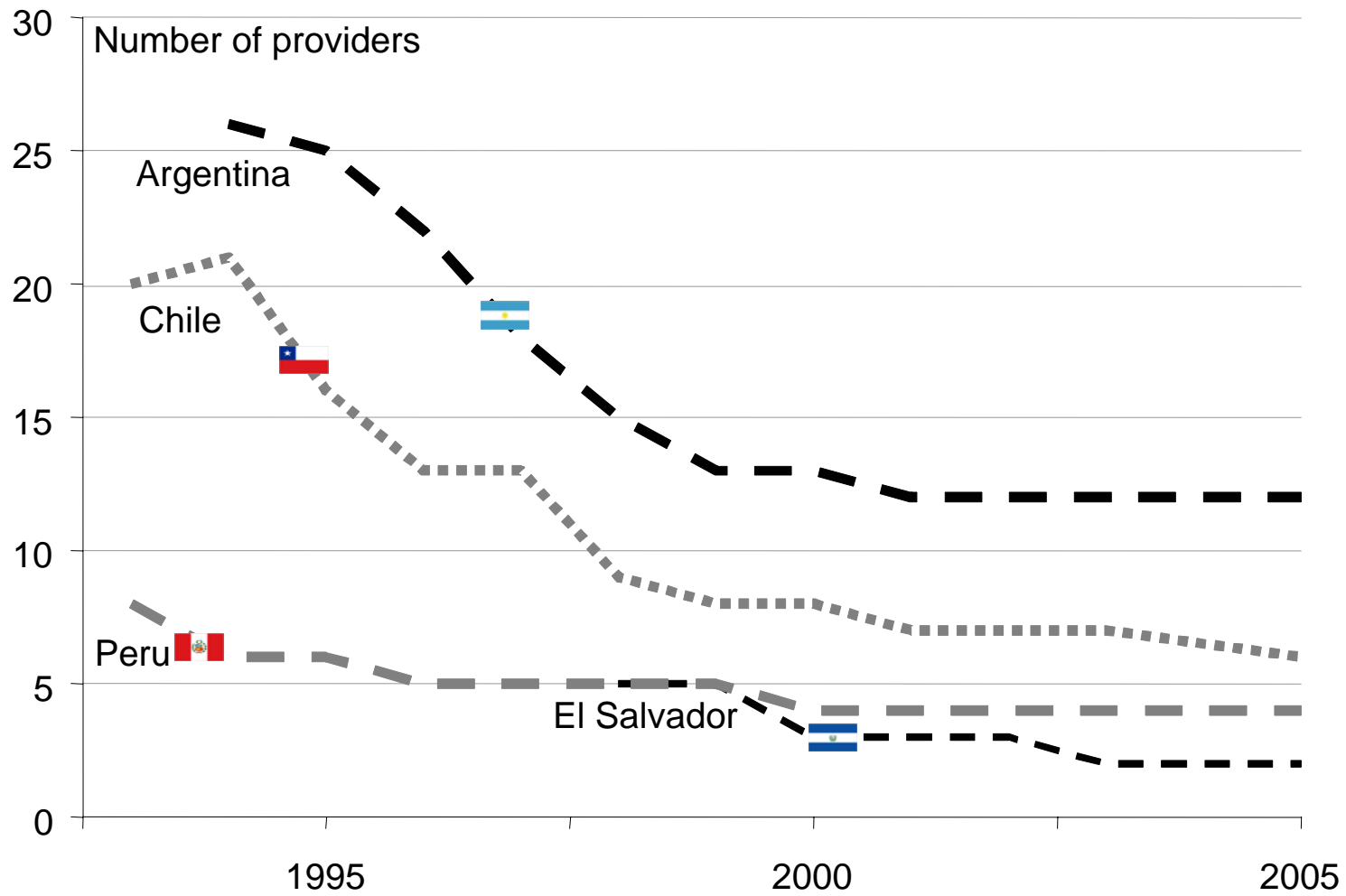
% of members	1978	1994
Investment choice		
Employee contributions	16	94
Employer contributions	10	74
Number of investment choices		
1	51	12
2	28	7
3	13	9
4	4	15
5+	4	58

# Individual choices

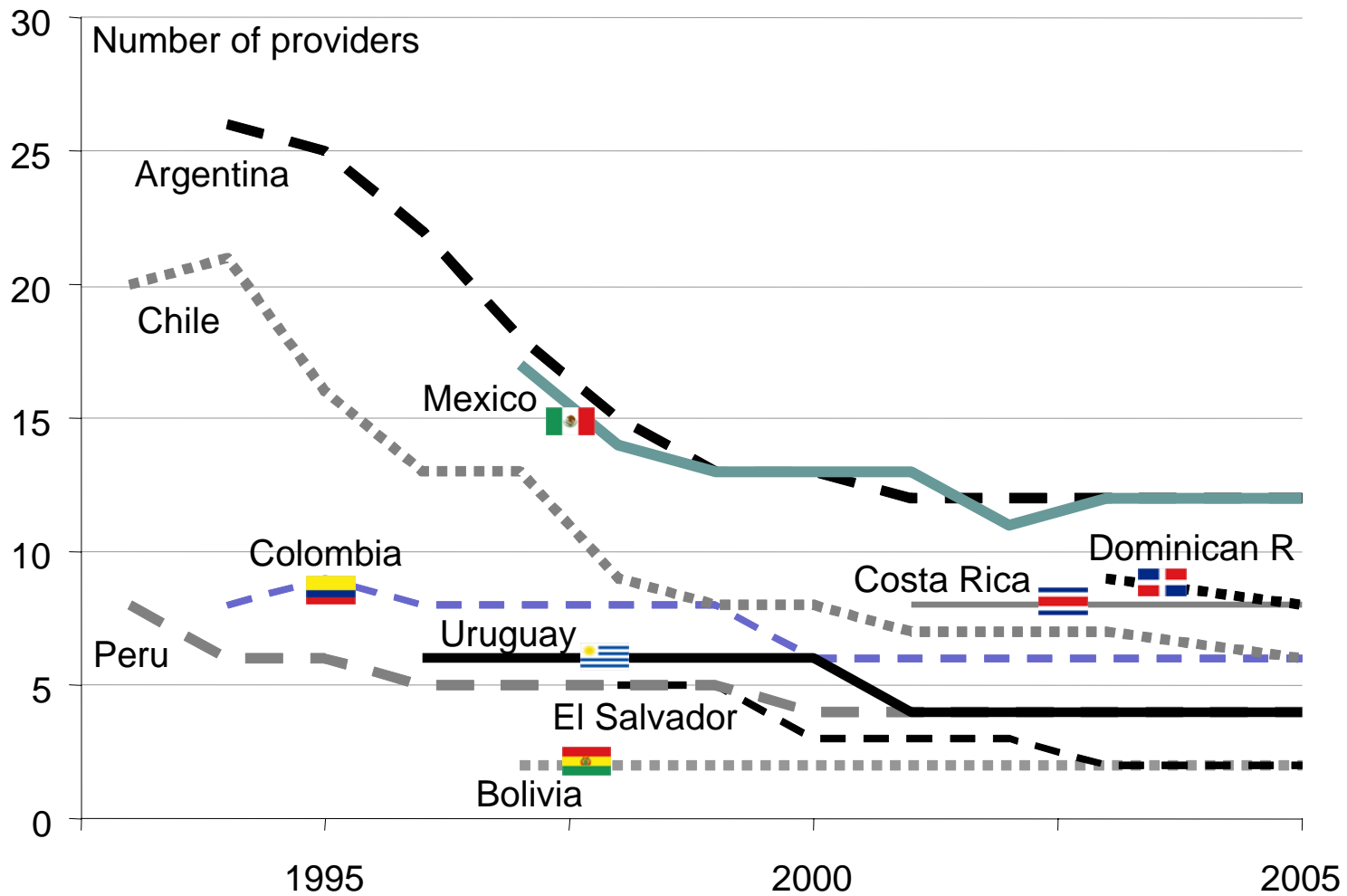
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 Consolidation has cut number of providers in many cases

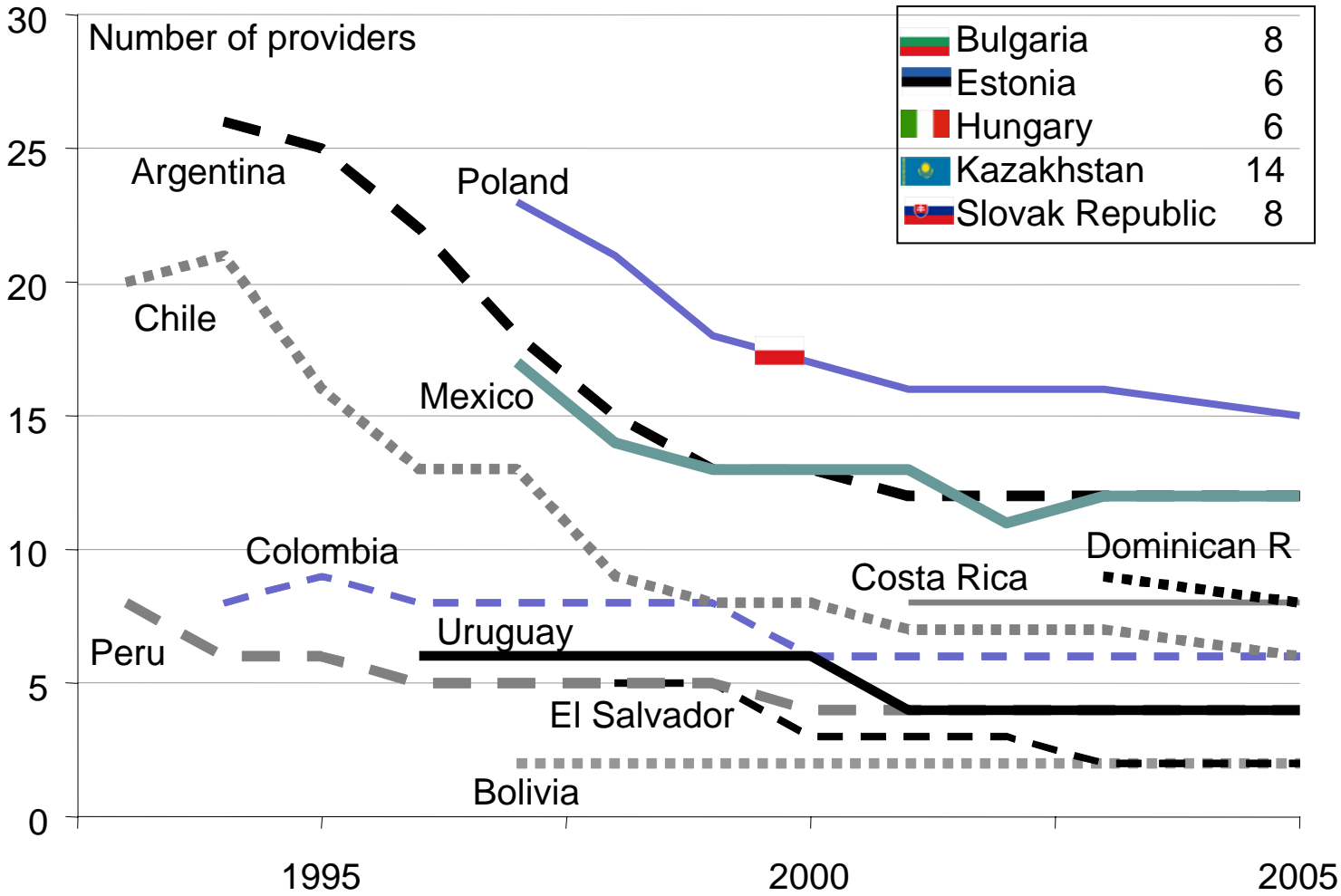
# Consolidation: Latin America























# Consolidation: Latin America



# Consolidation: Eastern Europe



# Individual choices

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□ But there has been a move to greater investment choice

# Portfolio choices

□ Mexico	2
□ Slovak Republic	2-3
□ Estonia	3
□ Peru	3
□ Chile	5

# How many investment choices?

- Choice increases welfare
- Choice increases participation
  - 50% of people eligible participate in 401ks without choice, 87% with choice
  - controlling for individual and employer characteristics, introduction of choice increases average contribution by 43%, from 5.1% to 7%

# How many investment choices?

- Demotivation and choice overload: consumer studies show more choice =
  - more interest
  - fewer purchases
  - more uncertainty over choices
- Distribution of choice in 401ks: 2-59 funds, median 13, 90% between 6 and 22.  
Effect of adding 10 funds to the menu
  - participation -2%
  - portfolio share of 'safe' investments: +5.4%ge pts
  - portfolio share of equities: -8%ge pts

# Conclusions

- Emphasis in Latin America and Eastern Europe was on choice of provider
- Only recently has there been a move towards choice of investment portfolio
- Consolidation has reduced range of provider choice
- OECD countries are actively considering different structural solutions to reduce costs
  - centralised collection of contributions
  - centralised recordkeeping
  - outsourced fund management
  - limited choice of investments