CURRENT STATUS

The OECD Secretariat has proposed seven new projects for consideration for addition to the work program beginning in 2015. These would be in addition to the work on Financial Incentives and Annuities that remains ongoing. They are seeking the advice of the delegations regarding relative priorities, how the work on high priority issues might be further developed, suggestions for projects not on the list and how any of the proposed projects might be consolidated. More extensive project proposals for work deemed to be worth pursuing will likely be presented at the June meeting for final approval.

SUMMARY OF THE DOCUMENT

Secretariat has proposed the following projects for consideration:

1) Diversification between public and private pensions
2) Cost of running funded private pension
3) Conflict of interests in pension advice
4) Facing the challenges of a low return environment
5) Improving the structure of the pay-out phase of pensions
6) Continuing with the discussion about the need to adjust the classification of private pension plans
7) Agency problems, asymmetric information and governance

Only No. 3 on the list has been developed in any depth. This is due to the strong interest of DOL in this issue and their role in the U.S. delegation.

PROPOSED COMMENTS

1) Any evaluation of the interactions between public and private pensions will need to be carefully specified to be useful. This is such a broad topic and the
approaches so diverse among countries that any analysis will need to be relatively narrow to provide useful findings. As is suggested in the methodological discussion on financial incentives a narrower version of this kind of analysis may be feasible to integrate into the project on financial incentives – likely best by considering how financial incentives for private plans are coordinated with the design and operation of a public system and the outcomes that are associated with different designs. This would have to be integrated into the financial incentives projects at a later stage.

2) The way in which the project on fees and expenses is presented is predicted on an unproven assumption – that costs are too high. This raises the question of too high in comparison to what as there remains no consensus on an appropriate cost level. While there is no doubt that any level of expenses will lower the value of benefits and the relationship is non-linear as a result of a compounding it is not clear what level of expenses are justified by the unique nature of any particular private pension system. Any analysis of this sort therefore should be framed in terms of documenting the range of approaches in system design in relation to cost and expense levels and considering the how these are related to the outcomes that are achieved. This will inevitably impose some rather substantial challenges in developing metrics to measure both costs and outcomes and most significantly how to incorporate investment risk into any measurement of the investment outcomes. Therefore any such study should be implemented in stages beginning with the updating of data on costs and design and then developing an approach to evaluating these in relation to outcomes. Given the formidable nature of the data and methodological challenges and the inherent risks this would seem to be a larger project than could be undertaken, especially considering the very ambitious effort underway on financial incentives that imposes similar scope and methodological challenges.

3) Similarly the project labelled “Conflicts of Interest” is presumptive and negative in its presentation. An effort in this area should be presented in terms of evaluating the alignment and divergence of incentives inherent in different regulatory frameworks utilized to govern the provision of investment advice for the members of individually directed pension funds which is somewhat how it is ultimately presented in the later parts of the proposal. Although the forthcoming US regulations are directed to defining and prohibiting conflicts of interest in these arrangement this is a very narrow way to frame such a study that if reflective of a relative specific aspect of US law (the manner in which ERISA defines a fiduciary and the strong reliance on prohibitions against conflicts of interest and self-dealing) that will bias the results and limit its usefulness. Consideration should be given to reformulating such a project to be more general in approach, that is to document the different approaches that have been implemented or proposed to make investment advice available to individuals, develop a framework for the evaluation of the incentive structure that these are
likely to produce and to determine if there is any cross country evidence that desired outcomes (e.g. higher rate of take-up of advice, better long term outcomes in risk adjusted returns) can be found. This could be done in two parts by first collecting practices and evaluating the incentive structure and second measuring outcomes (if not causality perhaps correlations) that are discernible. Taking a broader approach will lead to a broader consideration of policy options that will make such an effort more useful and broadly applicable

4) Rather than taking a theoretical and prescriptive approach to the low returns environment that is suggested by the brief write up on this project consideration should be given to documenting and evaluating what various countries have actually done when faced with this challenge, the potential risks that are associated with different approaches and lessons that can be learned from this experience. These will range from temporary reductions in funding, reserve or capital requirements to relaxation of investment restrictions (formally or informally) to enable fund managers to take greater risks to achieve higher returns. Some systems that utilize a relative rather than normative model of investment control (by reference to common or prevailing practice in prudent person systems) may be more inherently flexible to address such a challenge. This kind of analysis however imposes so many methodological issues to accommodate all of the various systems and responses and we are still early in the process having not run the full cycle resulting from the 2008-2009 crisis that it may not be practical to try to address this issue at this point in time.

5) The proposed project on improving the pay-out phase, as is suggested, is likely best undertaken as an extension of the annuity regulation study. It appears to be simply an extension from formal annuity projects to consideration of other types of arrangements that fulfil the same function. The suggested work in financial capability and education is likely best left within the larger OECD effort on Financial Literacy and Education that is more likely to place it in a better overall context relative to other kinds of financial behaviour and consumer protections.

6) Revision of the classification of pension systems to improve the presentation and utility of statistics is relatively low cost and, unlike some of the other proposal does not entail high feasibility risks. It should have a meaningful payoff and therefore should be supported.

7) The final project on governance, agency and asymmetric information is not sufficiently formulated in this presentation to enable a meaningful assessment so should be deferred until it can be more fully developed for consideration.