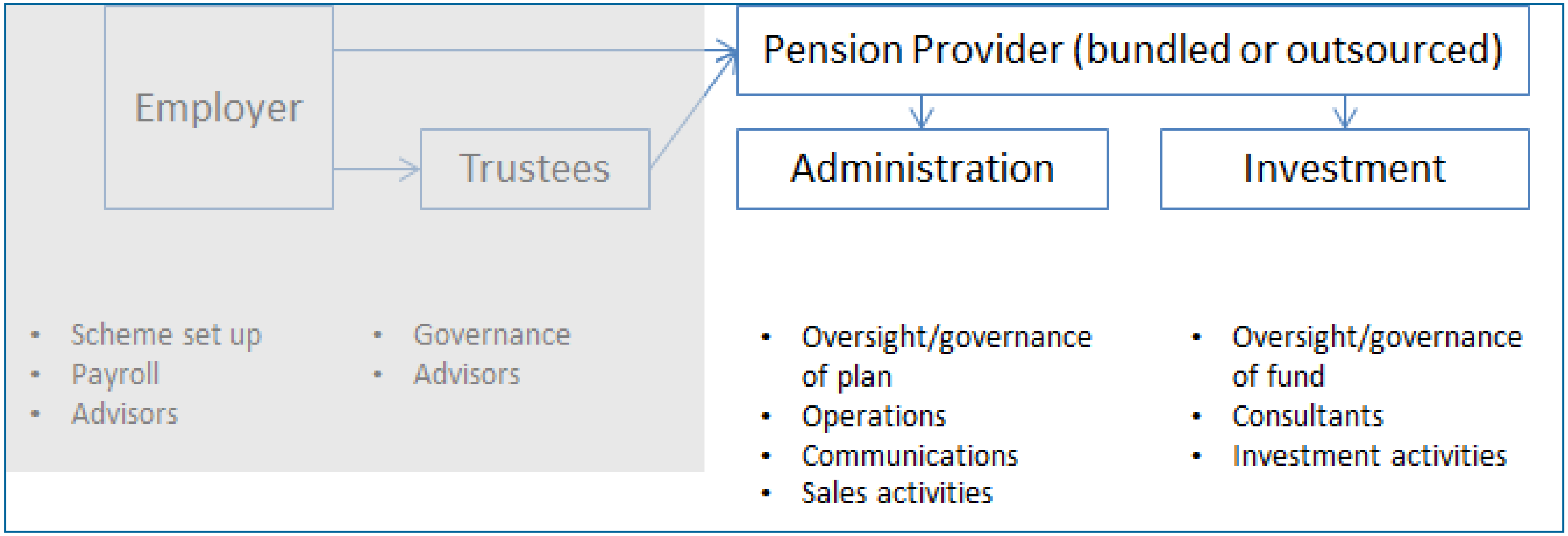
COSTS AND VALUE FOR MONEY IN DC PENSIONS

CEPS 20 March 2018

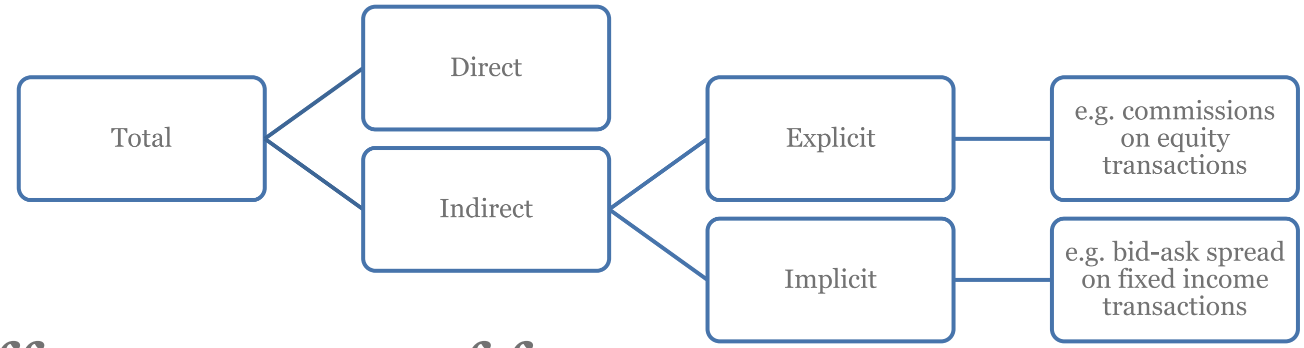
Fees and costs are not the same

- Charges by pension provider ≠ costs to pension fund member
- All "payments out" reduce the potential pension pot
- Whether charged up-front, out of assets or ad hoc



Difficult to get a full picture

- Different types of cost



- Different types of fee
  - Flat rate, % of contribution, % of assets, performance-related, loyalty bonus…
- Provider costs evolve with membership – require different charging levels and structures

Weak competitive pressures

- Lack of engagement
- Complex and opaque charging structures
- Weak governance
- Barriers to entry/switching
- Failure to exploit economies of scale

Policy responses

- Disclosure
  - Transparency from providers, easier comparisons for members
- Pricing regulations
  - Charge caps, charging bases
- Structural solutions
  - More providers, auctions, centralised institutions, scale, governance

Disclosure can be effective

Cost data 5 largest pension funds NLD

Costs of asset management (bp)	2010	2011	2012	2013
ABP*	39	64	73	76
PFZW	48	55	57	61
PMT	17	62	54	40
BPF Bouw	52	46	50	58
PME	70	53	37	29

But not by itself

	Lack of engage-ment	Opaque charging structures	Weak governance	Barriers to entry/ switching	Failure to exploit economies of scale
Australia	x	x	x	x	x
Canada	x	x			x
Chile	x	x			
Costa Rica		x			x
Denmark	x	x			
Hong Kong, China	x	x		x	x
Italy	x				
Mexico	x	x		x	x
Netherlands	x	x	x		x
Turkey		x			x
UK		x	x	x	x
USA	x	x	x		

Value for money

- Low cost ≠ good value
  - Members benefit from high service levels; complex investment strategies may deliver higher pension payments…

- But lower cost = better value

What is VFM?

- The rate at which contributions are transformed into portfolio assets
- System-level value for money
  - Qualitative and quantitative indicators
  - Charging structures and price regulation
- Provider-level value for money
  - Benchmarking cost and quality
- Investment portfolio value for money
  - Cost transparency
  - Risk and return versus reward

System-level value for money

- Qualitative and quantitative objectives
  - NZL: encourage saving and financial independence
  - AUS: competitiveness and efficiency
  - GBR: assets, security, trust

- Low cost is not an end in itself but is a driver of value for money

System-level indicators of good value

- Transparency
- Fee caps
- Measures that address asset-based fees directly
  - Declining fee caps
  - Loyalty bonuses
  - Fixed fees
- Potential to borrow from other sectors
  - Performance-based regulation and benchmarking

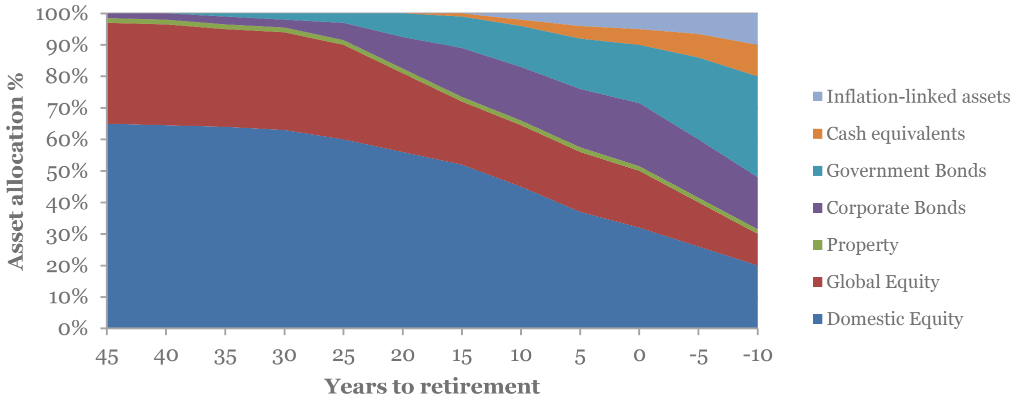
Provider-level value for money

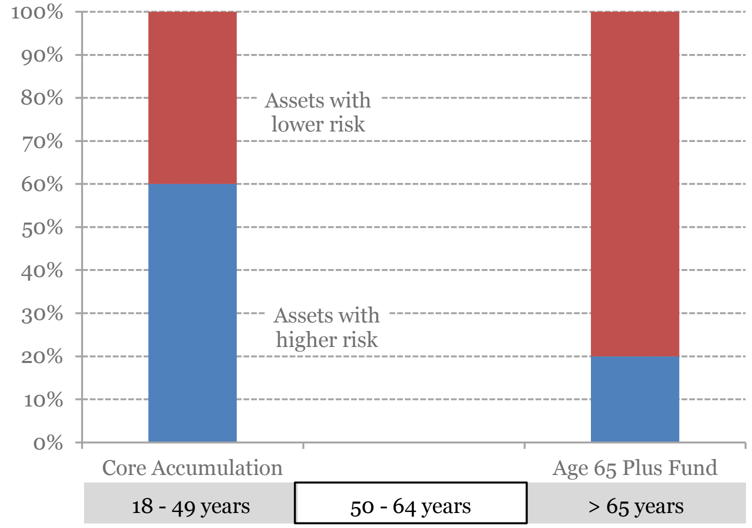
- Objective: build pension assets
- Activities : administration and investment
- VFM = high quality activities at low cost
- But: different membership profiles, investment strategies, administrative requirements
  - How to set a benchmark/reference
  - How to access relevant data

Provider-level vfm

	NEST Retirement Date Funds (UK)	Thrift Savings Plan (US)	MySuper – Industry level (AUS)	AP 7 Safa (Sweden)	DIS – industry level (HK-China)
AuM	GBP 1.7 bn	USD 500 bn	AUD 474 bn	SEK 328 bn	HKD 15.4 bn
Investment strategy	Target date	Lifecycle/building blocks	Lifecycle and single strategy	Lifecycle	Lifecycle
Return target	CPI + 3% Volatility target for each stage	Market indices for each of bond and equity components	CPI over 10 years	Average return of private sector PPM funds	Market indices for each of bond and equity components
Returns (5-year annualised)	Range 1.9% - 11.4%	Range 1.5% -2.3%	6.6%	19.5%	n.a.
Fees - *asset-based*	3 bp	3.8 bp administration	49 bp	11bp in growth phase reducing to 6 bp at age 75	75 bp investment management
- *other*	180 bp per contribution	0-1.2 bp stock lending	AUD 87 annual administration fee per member*	-	20 bp recurrent operating expenses
- *total as % of AuM*	50 bp	3.8-5 bp	≈50 bp	6-11 bp	95 bp
Direct transaction costs as % AuM	Range 0-4.9 bp	n.a.	n.a.	n.a.	n.a.

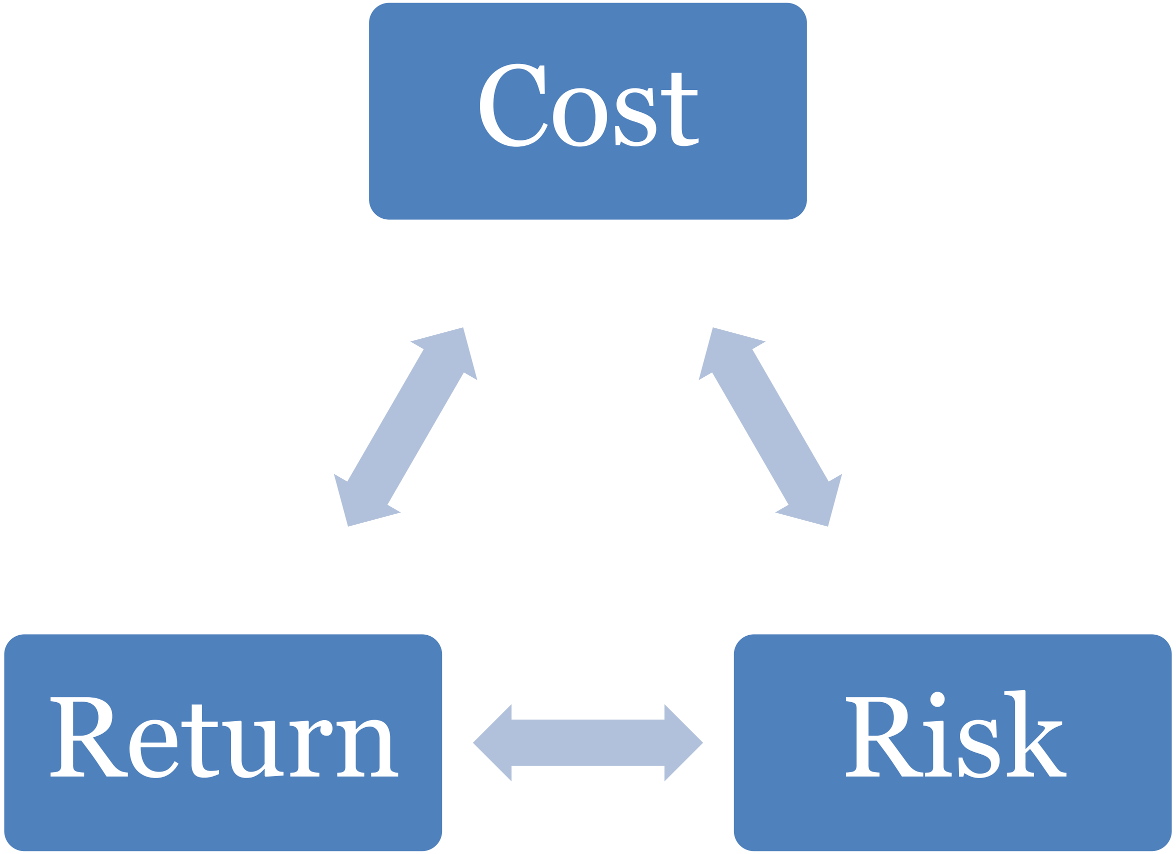
Lifecycle allocation





Value for money in investment portfolios

- Investment costs do not exist in isolation



Preliminary findings

- No single measure is effective in isolation
- Cost transparency is necessary but not sufficient for containing total member reductions
- Measures to stimulate market mechanisms work best when reinforced by pricing regulation and structural solutions
- Policy needs to evolve over time
- The role of the regulator is critical in creating a transparent and responsible intermediary chain

THANK YOU!

QUESTIONS OR COMMENTS?

BETTER POLICIES FOR BETTER LIVES