

Institute of Actuaries of Australia

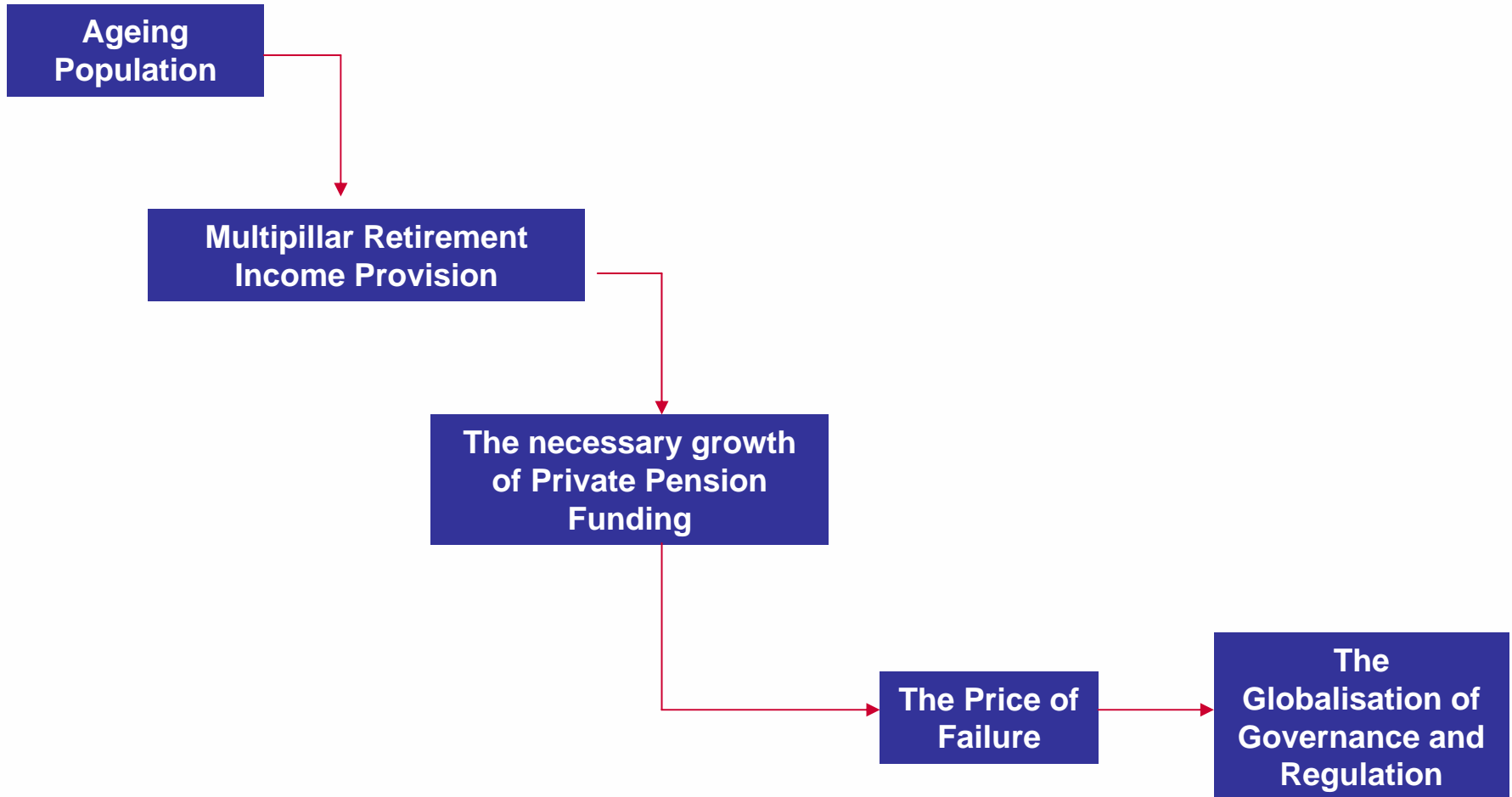
# **INTERNATIONAL PENSION REGULATION - Key Directions**

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# The Drivers



# The Key Message

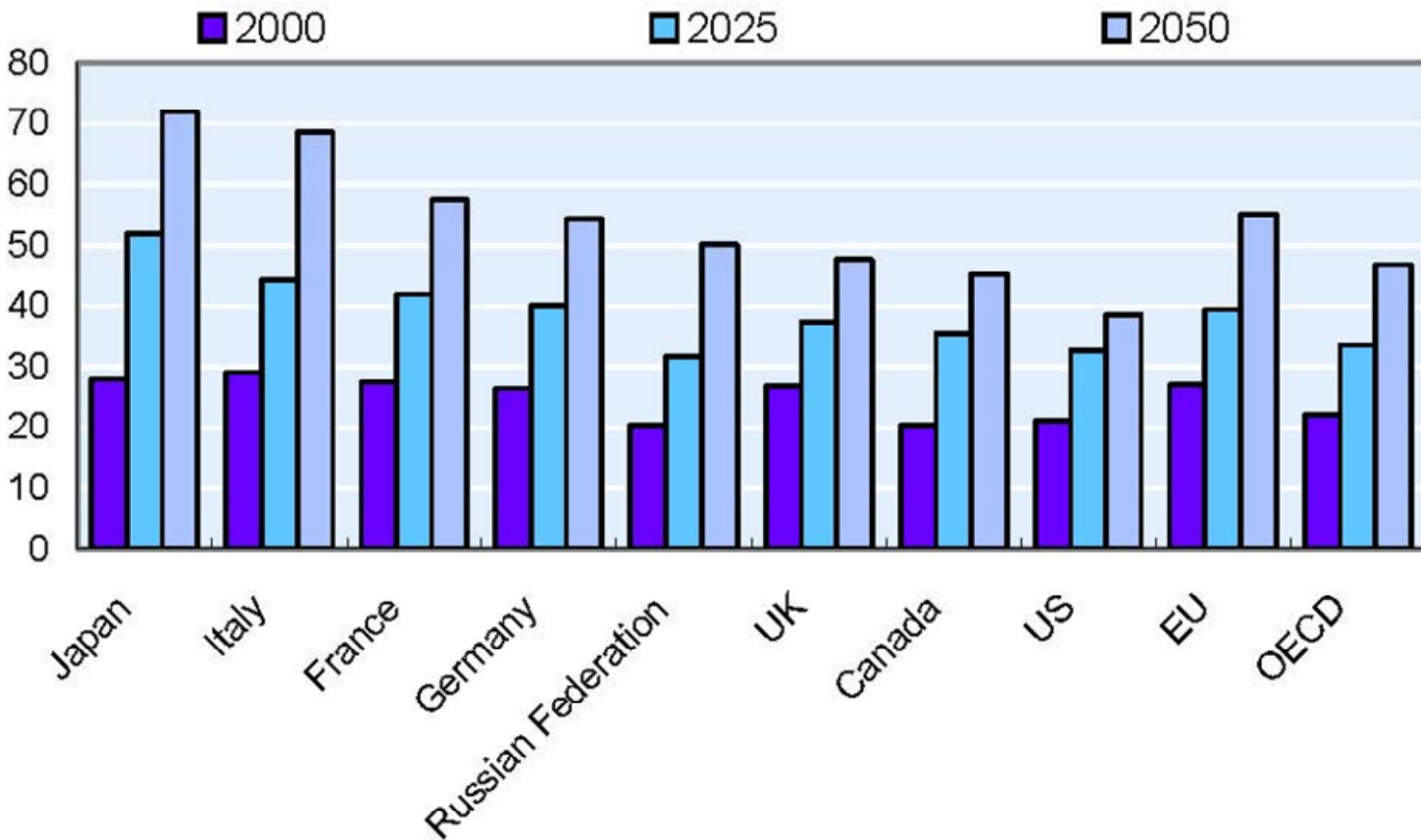
- If private provision is inevitable then good governance is critical
- Actuaries must understand governance and their role in it.



# Ageing Populations

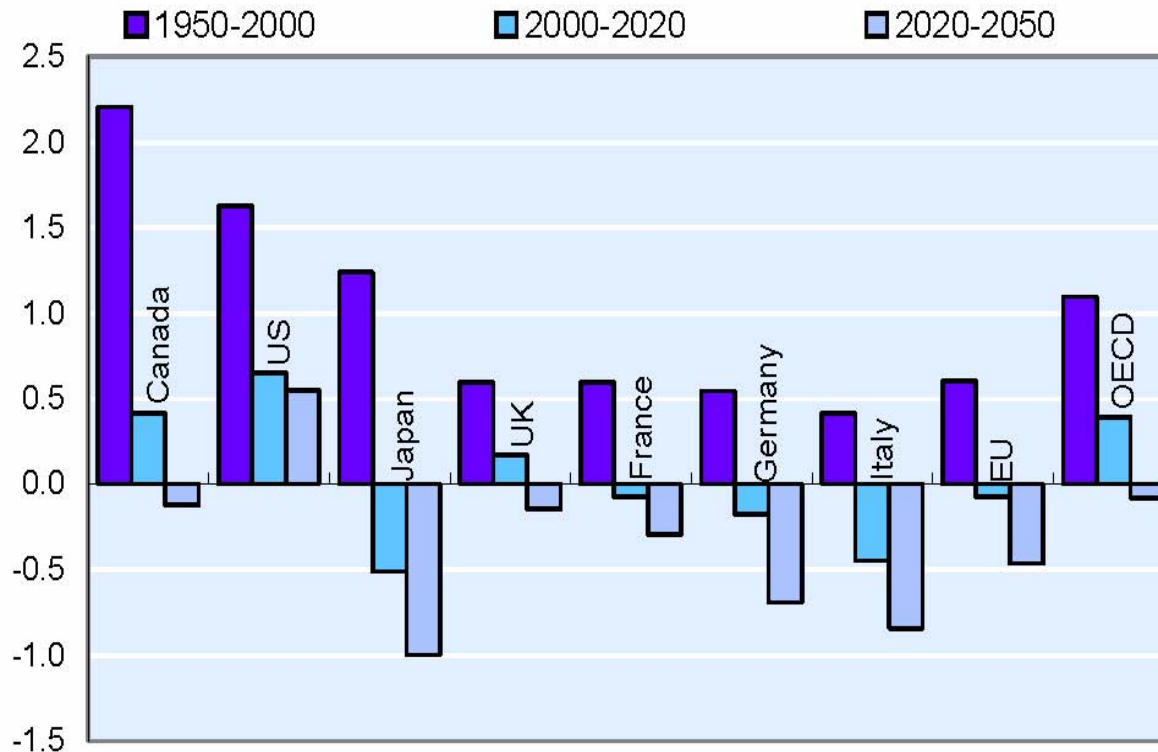
## – The rapid growth of dependency

Old-age dependency ratio



# Ageing Populations

## – The rapid growth of dependency



Ageing populations are forcing governments to focus on retirement income provision.

OECD



# **The Growth of Private Pension Funding**

**“ Pension funds have grown exponentially over the past 10 years and represent one of the largest accumulations of capital in the world. Global retirement assets are well in excess of \$US 15 Trillion and expected to grow at an exponential rate in the future thanks to demographic and economic forces.....”**

**Barry McInerney, Mercer Consulting**



# The Growth of Private Pension Funding

	Retirement Assets	GDP	Retirement Assets on 0% of GDP	Equity Allocate as % of total fund	Non domestic equity allocation as % of total fund
	\$US T	\$US T	%	%	%
Australia	0.4	0.4	100	65	29
Canada	0.8	0.7	114	53	26
Germany	0.3	2.0	15	22	1
Japan	1.7	3.9	44	50	20
Netherlands	0.6	0.4	150	50	41
Switzerland	0.4	0.3	133	28	10
UK	1.7	1.6	106	61	24
USA	10.2	10.4	98	61	14

Sources: The Economist, Greenwich Associates, ICI, Mercer, OECD



# The Price of Failure - UK

- **Robert Maxwell and the Mirror Pension Funds**

- Some £450 of Pension Fund Monies lost through investment in Mirror Companies.

- **Equitable Life**

- Unsustainable pension guarantees forced the closure to new business of the oldest [ and one of the most prestigious] UK life insurers



# The Price of Failure - USA

- **Litigation by 401(k) participants – recent high-cost settlements:**
  - Global Crossing: \$79m total; former chairman \$25m individually
  - WorldCom: \$47m total; former CEO \$400,000 individually
  - Enron: up to \$86m total; former outside directors, \$1.5m individually
- **Mutual fund controversies – Spitzer and SEC investigations**
- **Escalating D&O and ERISA insurance premiums**
- **Increased governance scrutiny of tax-exempts by Congress and IRS.**

Gina Marsalas, Mercer Consulting



# **The Price of Failure - USA**

## **- mutual fund issues hitting the press...**

### ***Short-term trading:***

*Buying and selling a fund to “arbitrage”  
Short-term profits*

### ***Late trading:***

*Illegally placing orders after the 4:00p.m.  
market close.*

### ***Soft-dollar compensation:***

*Receiving research and other “compensation”  
in exchange for placing transactions with a  
brokerage firm.*

### ***Pay to play:***

- Brokerage firms emphasizing of funds that make special payments to the firm.*
- Placing funds in plans due to financial compensation to plan administrator or consultant.*

### ***Fair Value pricing:***

*Ability to reflect in the mutual fund price post-close market changes that could affect the value of the underlying securities.*

### ***Revenue sharing:***

*Administrative costs paid from mutual fund fees.*

Gina Marsalas, Mercer Consulting



# The Globalisation of Governance

## Economic drivers

- Individuals rely on the providers for financial security
- Economies rely on private long-term savings

## Global developments

- Insurance providers are becoming more global
- Global employers have multi-national operations
- Political pressures are for world financial markets
- The IT revolution facilitates cross-border marketing and sales

Paul Thornton, Watson Wyatt  
World Bank Conference  
On Savings and Investment



# The Globalisation of Governance

## Developing countries

- Developing countries aspire to be “world class”

## Reputation

- Reputation for high standards is vital to leading global marketplaces

Paul Thornton, Watson Wyatt  
World Bank Conference  
On Savings and Investment



# **The Globalisation of Governance - The Players**

- **International Accounting Standards Board**
- **International Association of Insurance Supervisors**
- **International Organisation of Pension Supervisors**
- **Committee of European Insurance and Occupational Pension Supervisors**
- **European Commission /OECD/ Basel Committee**

**Paul Thornton, Watson Wyatt  
World Bank Conference  
On Savings and Investment**



# The Globalisation of Governance -Supervisory Structures

<b>INTEGRATED</b> (Banks, Securities, Insurance Companies, Pension Funds)	<b>PARTIALLY INTEGRATED</b> (Insurance Companies and Pension Funds)	<b>SPECIALISED</b> (Pension Funds)
Australia Austria Canada Denmark Germany Hungary Iceland Korea Norway	Belgium Czech Republic Finland Luxembourg Netherlands New Zealand Poland Portugal Spain Turkey	Ireland Italy Japan Mexico Slovak Republic Sweden Switzerland United Kingdom United States

Source: Replies to the OECD Secretariat Questionnaire.



# The World Bank Multi-pillar Approach

Pillar	Target Group			Characteristics	Participation	Funding or Collateral
	Lifetime Poor	Informal Sector	Formal Sector			
0	X	X	x	“Basic” or “social pension,” at least social assistance (universal or means tested)	Universal or residual	Budget or general revenues
1			X	Public pension plan, publicly managed (defined benefit or notional defined contribution)	Mandated	Contributions, perhaps with some financial reserves
2			X	Occupational or personal pension plans (fully funded defined benefit or fully funded defined contribution)	Mandated	Financial assets
3	x	x	X	Occupational or personal pension plans (partially or fully funded defined benefit or funded defined contribution)	Voluntary	Financial assets
4	X	X	X	Access to informal support (family), other formal social programs (health care), and other individual financial and non-financial assets (home ownership)	Voluntary	Financial and non-financial assets

Public

Private

Other

*Note: The size and appearance of x reflect the importance of each pillar for each target group in the following increasing order of importance: x, X. X.*



# Good Governance – the OECD Guidelines

“Regulations on pension fund governance need to be guided under the overriding objective that pension funds are set up to serve as a secure source of retirement incomes”

## I. Governance Structure

The governance structure should ensure an appropriate direction of operational and oversight responsibilities and the accountability and suitability of these ???such responsibilities.

1. Identification of Responsibilities – There should be a clear identification and assignment of operational and oversight responsibilities in the governance of a pension fund.
2. Governing Body – Every pension fund should have a governing body vested with the power to administer the pension fund and who is ultimately responsible for ensuring the coherence to be terms of the arrangement and the protection of the best interests of plan members and beneficiaries.
3. Expert Advice – Where it lacks sufficient expertise to fill in information to fulfil its responsibilities the governing body could be required by the regulator to seek professional advice to appoint professionals to carry out certain function.



# Good Governance -the OECD Guidelines

4. Auditor – An auditor independent of the pension entity, the governing body and the plan sponsor should be appointed.
5. Actuary – An actuary should be appointed by the governing body for all defined benefit plans financed via pension funds.
6. Custody – Custody of the pension fund assets may be carried out by the pension entity. The financial institute manages the pension fund and by an independent custodian.
7. Accountability – The governing body should be accountable to the pension plan members and beneficiaries and the competent ???
8. Suitability – The governing body should be subject to minimum suitability structure.



# Good Governance

## - The OECD Guidelines

### II. Governance Mechanisms

Pension funds should have appropriate control, communication and incentive mechanisms that encourage good decision making, proper and timely executive, transparency, and regular review and assessment.

9. Internal Controls – There should be appropriate controls in plans to ensure that all persons and entities with operational and overnight responsibilities act in accordance with the objectives set out in the pension entities by laws structure, ??? on this instrument, or in documents associated with any of these and that they comply with the law.
10. Reporting – Reporting channels between all pensions and entities involved in the administration of the pension fund should be established in order to ensure the effective and timely transmission of relevant and actual information.
11. Disclosure – The governing body should disclose relevant information and all policies involved.
12. Redress – Pension Plan members should be granted access to statutory redress mechanisms.



# OECD Core Principles of Occupational Pension Regulation

## 1. Conditions for effective regulation and supervision

An adequate regulatory framework for private pensions should be enforced in a comprehensive dynamic and flexible way ... in order to ensure the protection of the pension plan members and beneficiaries, the soundness of pension plans and finds the stability of the economy as a whole.

## 2. Establishment of pension plus, pension funds and pension fund managing companies

An institutional and functional plan with adequate legal, accounting, technical, financial and managerial criteria should apply to pension funds and plan, jointly or separately, but without excessive administration burden.

## 3. Pension plan liabilities, funding rates, winding up and insurance

Private occupational plans should be funded. Proper winding up mechanism should be in place.



# OECD Core Principles of Occupational Pension Regulation

## 4. Asset Management

Investment by pension funds should be adequately regulated, increased reliance on modern and effective risk management should be promoted.

## 5. Rights of members and beneficiaries and adequacy of benefits

Non discriminatory access should be granted to private pension schemes ... Appropriate disclosure in education should be promoted as regard to respective costs and benefits characteristics of pension plans especially where individual choice is offered.

## 6. Supervision

Effective supervision of pension funds and plans must be set-up and focus on legal compliance financial control actuarial examination and supervision of managers.



# Eight Questions for the Future

1. Should pension regulators be concerned that the asset allocation strategies of pension funds may reflect an employer sponsor's concern with the manner in which liabilities are reflected in the company's balance sheet, its ratings and share value – especially *if the asset allocation strategy absent consideration for those concerns, would be materially different?*
2. What is the relationship between accrued rights (ABO/PBO) and investment strategy? Should regulators take a more holistic view of the measurement of liabilities, funding rules and investment regulation? In doing so, is there a clear impact on the nature of investment regulation?
3. How should pension regulators of defined benefit plans and collective DC arrangements react in times of significant market volatility, which, on the one hand may reveal weaknesses in the regulatory infrastructure that may need to be addressed and on the other hand, may cause regulators to overreact, act precipitously, and unnecessarily over-regulate?
4. Requiring defined benefit and collective DC arrangements to have surplus to buffer against market downturns may be a prudent regulatory strategy. How would an appropriate level of surplus be determined? Is there a downside to this approach to benefit security?



# Eight Questions for the Future

5. *Do investment regulations require some form of asset-liability matching? Do mature plans tend to invest more in fixed income securities?*
6. *How can regulators help individuals with substantial portfolio choice make appropriate decisions about asset allocation in light of the immunisation debate?* How to promote further financial education? Are there particular financial instruments suitable for individual investors in pension markets, the development of which might be encouraged?
7. *What are the current impediments to countries buying each other's bonds to diversify country risk in pension buffer funds and other government reserve funds?*
8. *Are sufficient quantities of financial instruments available, particularly at the long end of the maturity spectrum?*

David Lindeman OECD – Notes on issues for the regulation of the Investment of Pension Fund Assets - 3<sup>rd</sup> OECD/ INPRS Conference on Private Pensions in Asia, Manila – March 2004



# The Globalisation of Governance - The Actuarial Role?

- Architects or technicians?
  - Broad or narrow?
  - Global or local?

Our strengths are our global actuarial connection, our broader view of public interest and our capacity to understand institutional frameworks and make them work.

