

The philosophy of pensions regulation

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The philosophy of pension regulation

“Whereof one cannot speak, thereof one must be silent” Ludwig Wittgenstein

- The principles of regulation/supervision
- What is special about pensions and their regulation
- Strategic approaches/narratives
- Key messages

The principles of regulation/supervision

- Modern principle-based regulation developed to cover new markets (in the UK)
- Aim to mitigate market failure or systemic risk
- Regulation contrasts with command and control
- Its purpose: **achieving objectives through influencing worthwhile change or action**
- Working through other “actors” Providing incentives to move the market...
- ...while minimising unintended consequences and burdens
- Blurred distinction between regulation and supervision

The principles of good regulation (UK Better Regulation Executive)

- Targeting
- Proportionality
- Consistency
- Transparency
- Accountability

Difficult to deliver without a risk orientation

The essentials of regulation

- Understand the regulated landscape (research and reporting)
- Clarity about objectives and boundaries
- Identify what needs to change (and how quickly)
- Identify the threats (risks to the regulator)
- Recognise what can (largely) be left to others
- Understand what levers or incentives are available
- Develop regulatory priorities/themes/objectives
- Develop and communicate a strategy (narrative) that gains buy-in and manages expectations

What is special about pensions (the market failure)

The combination of:

- Very long term contracts
- Uncertainty about key variables
 - Longevity
 - Financial sufficiency
- Short term volatility of the assets (and measured liabilities)
- Sometimes, promises that cannot be executed
- Asymmetry of understanding
- Lack of transparency
- Agency risk
- Sometimes, operating in immature markets
- Crucially, the link to government welfare policy

Pensions regulators/supervisors have a range of objectives

- Encouraging/facilitating financial provision in old age
- Protecting members' benefits
- Improving take-up of pensions
- Strengthening financial markets
- Preventing or acting against financial crime
- Promoting financial stability
- Addressing agency risk
- Securing compliance with legislation(?)

But all are ultimately involved in addressing the risks of long term contracts

Strategic approaches to pensions regulation

Different approaches:

Structural regulation

Agency regulation

Rules-based regulation

Risk-based regulation

The approach depends on:

Nature of promise

Maturity of markets

Strength of fiduciary role

Risk appetite

Risk-based regulation has different meanings to different regulators

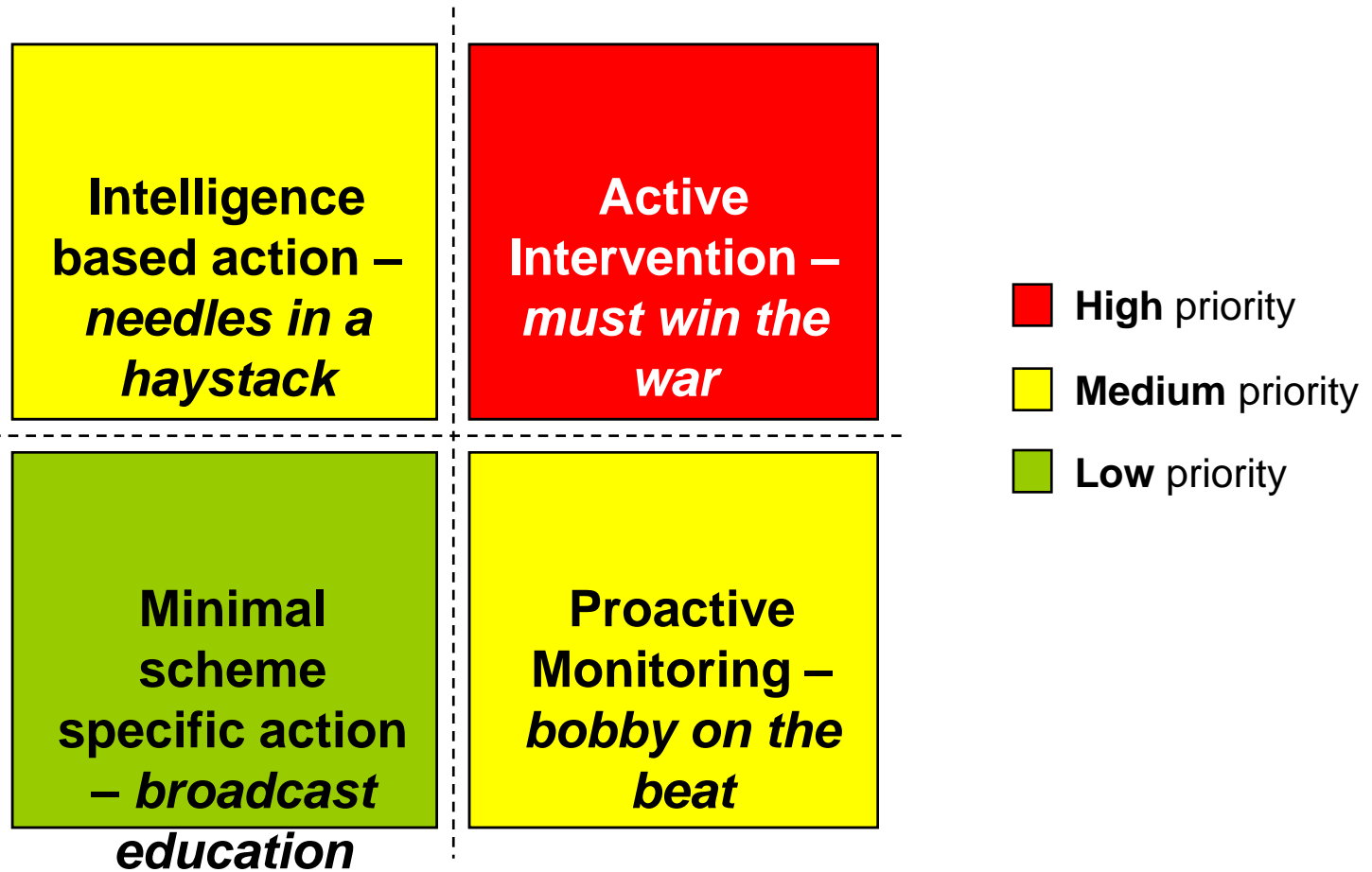
- Risk-based objectives and targets
- Under-pinning rules with economic substance/risk analysis
- Making choices transparent
- Focusing effort on the greatest risk
- Mitigating the impact of failure
- Clarity of narrative is therefore essential

See World Bank/IOPS studies of risk-based supervision

An overarching strategic narrative – the 3 E's

Education	<p>Preventive, broadcast, relatively cheap, limited feedback, relies on well-meaning intermediaries.</p> <p>Risk that it does not change behaviour</p>
Enabling	<p>Problem-solving, targeted, more resource-intensive, provides feedback, relies on honest intermediaries</p> <p>Risk that it becomes a crutch</p>
Enforcement	<p>Punitive/deterrent effect, remedial, can be proportionate, impact clear, most expensive</p> <p>Risk of disproportionate effort</p>

A narrative for impact and likelihood (The UK risk and intervention model)



Key messages

- Regulation/supervision needs to be grounded in evidence about risks in the pensions landscape
- Clear high level objectives are vital
- Diversity of landscape and objectives leads to diversity of strategic approaches
- Regulation works through third parties – influencing them is central to an effective approach
- There should be clearly articulated narrative

Any Questions?

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