

Supervision of Private Pension
Funds: Some Observations
About Context and Practices

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Purpose and Organization

- Theoretical Foundations for Supervision
- Framework for Evaluating Characteristics of Approaches To Pension Supervision
- Apply Classification Method to Eight Countries Representing Range of Supervision Systems
- Initial Observations About Relationships Between Context and The Design and Management of Supervision

What is Supervision

- Regulation:
 - Legal Foundations and System of Rules and Regulations Governing the Structure and Operation of Pension Funds
- Supervision:
 - Oversight and Enforcement of Compliance With The Rules
- May Occur Within The Same Organization and In Some Cases Simultaneously

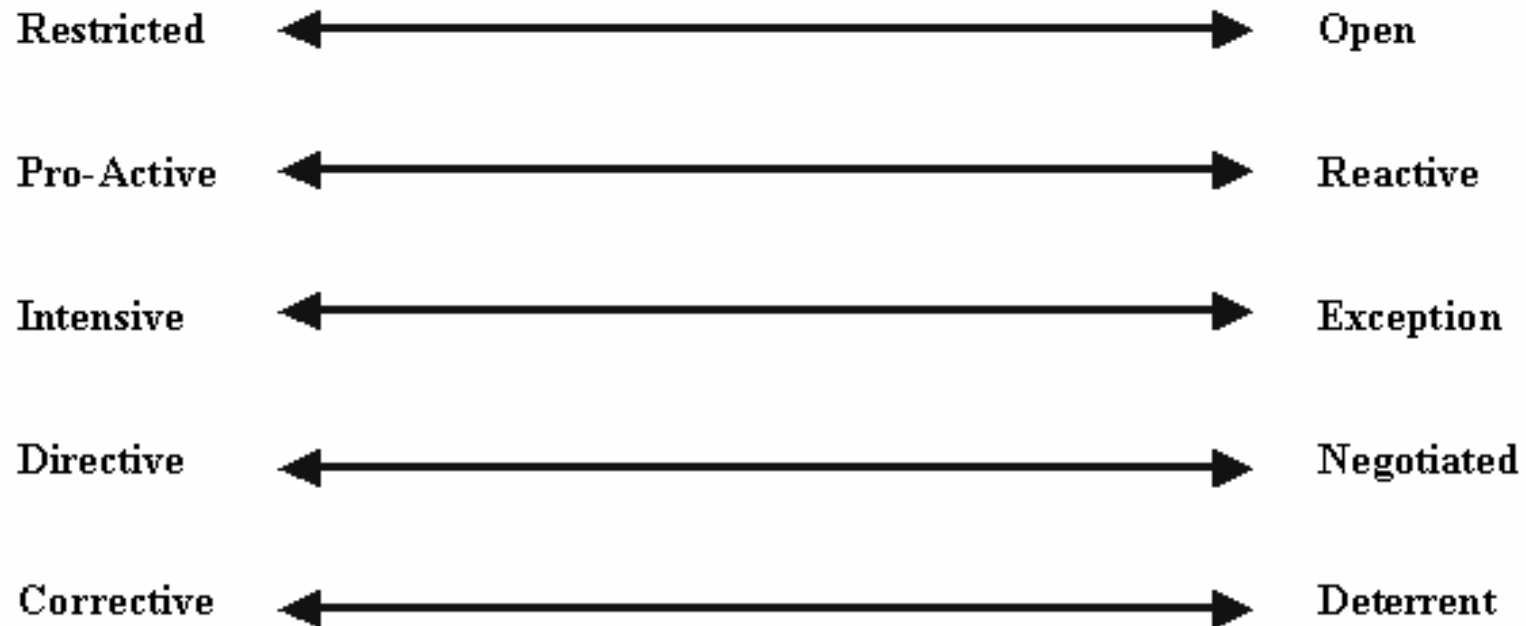
Theoretical Basis for Supervision

- Market Imperfections and Failures
- Asymmetrical Information
- Moral Hazard
- Consumer Myopia
- Competition and Efficiency

What Is Distinctive About Pensions?

- High Vulnerability Leads to Less Risk Tolerance
- Greater Share of Average Members Wealth
- Less Sophisticated Clientele – Low Income and Less Educated
- Mandates and Limited Choice By Consumer
- High Public Fiscal Exposure
- Complex Legal and Regulatory Systems

Atributes of Supervisory Systems



Elements of Supervision

- Monitoring
 - Financial Reporting and Auditing
 - Actuarial Reviews
 - On-Site Reviews and Investigations
 - Complaints & Whistleblowers
- Licensing
 - Pension Companies
 - Fund Managers and Trustees

Elements of Supervision (Cont)

- Communication
 - Disclosure
 - Outreach and Education
 - Training
- Measurement
 - Comparison to Normative Standards
 - Risk Based Methods

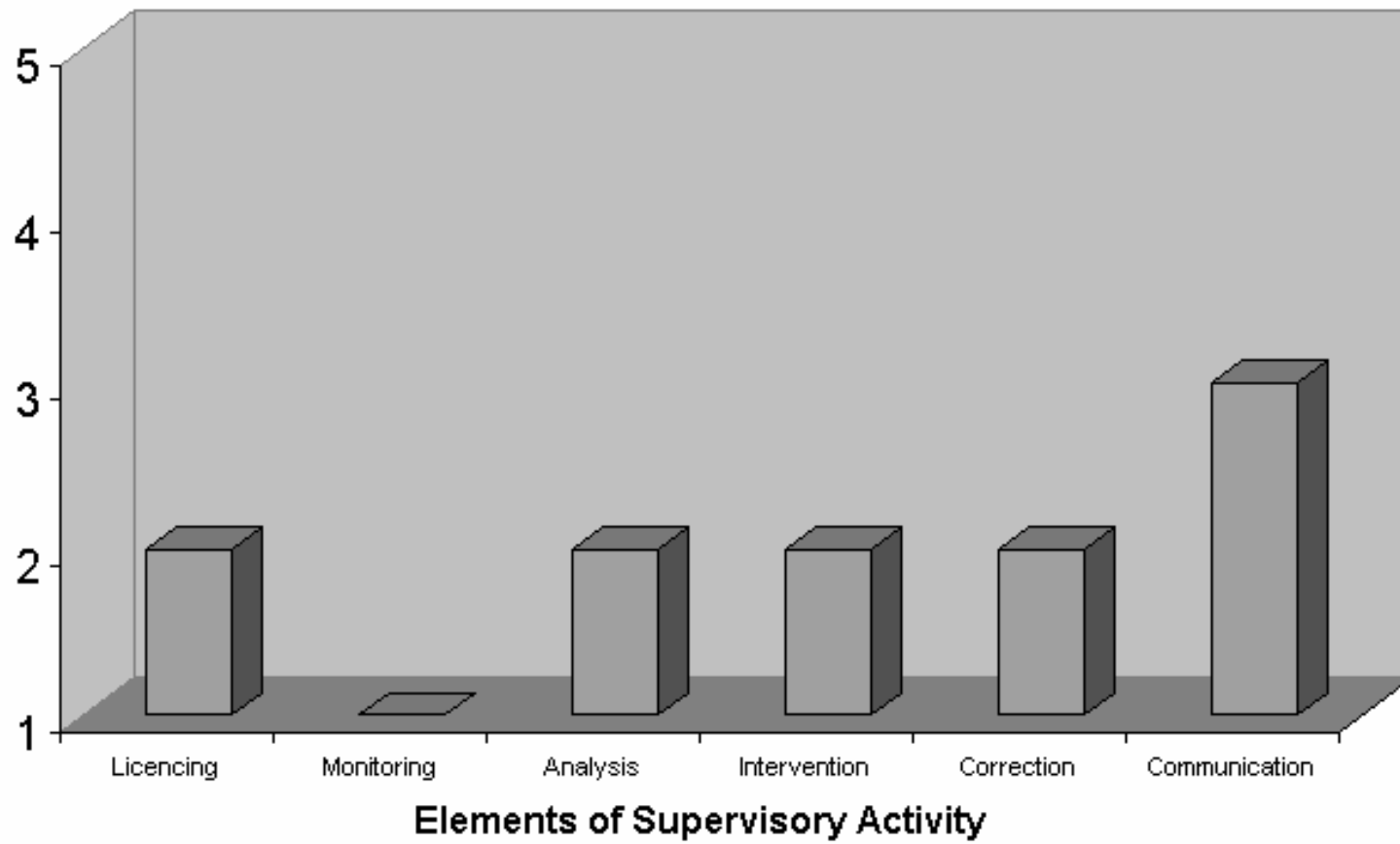
Elements of Supervision (Cont)

- Intervention
 - Notification of Violations
 - Directive Actions
- Correction
 - Punitive
 - Remedial
 - Compensatory

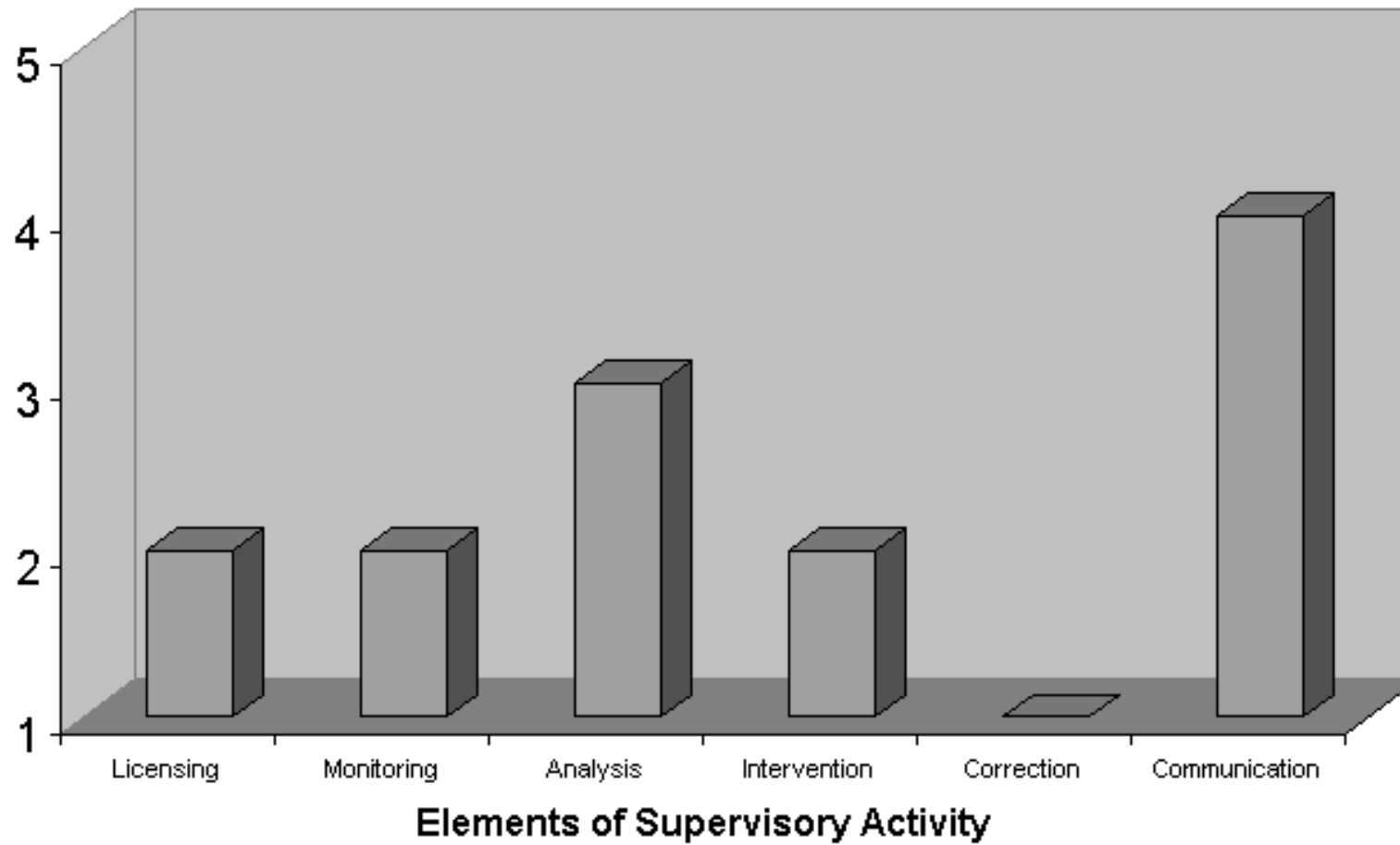
Representative Countries

- Ireland
- Australia
- Hong Kong
- Hungary
- United States
- Argentina
- Chile
- Mexico

Ireland



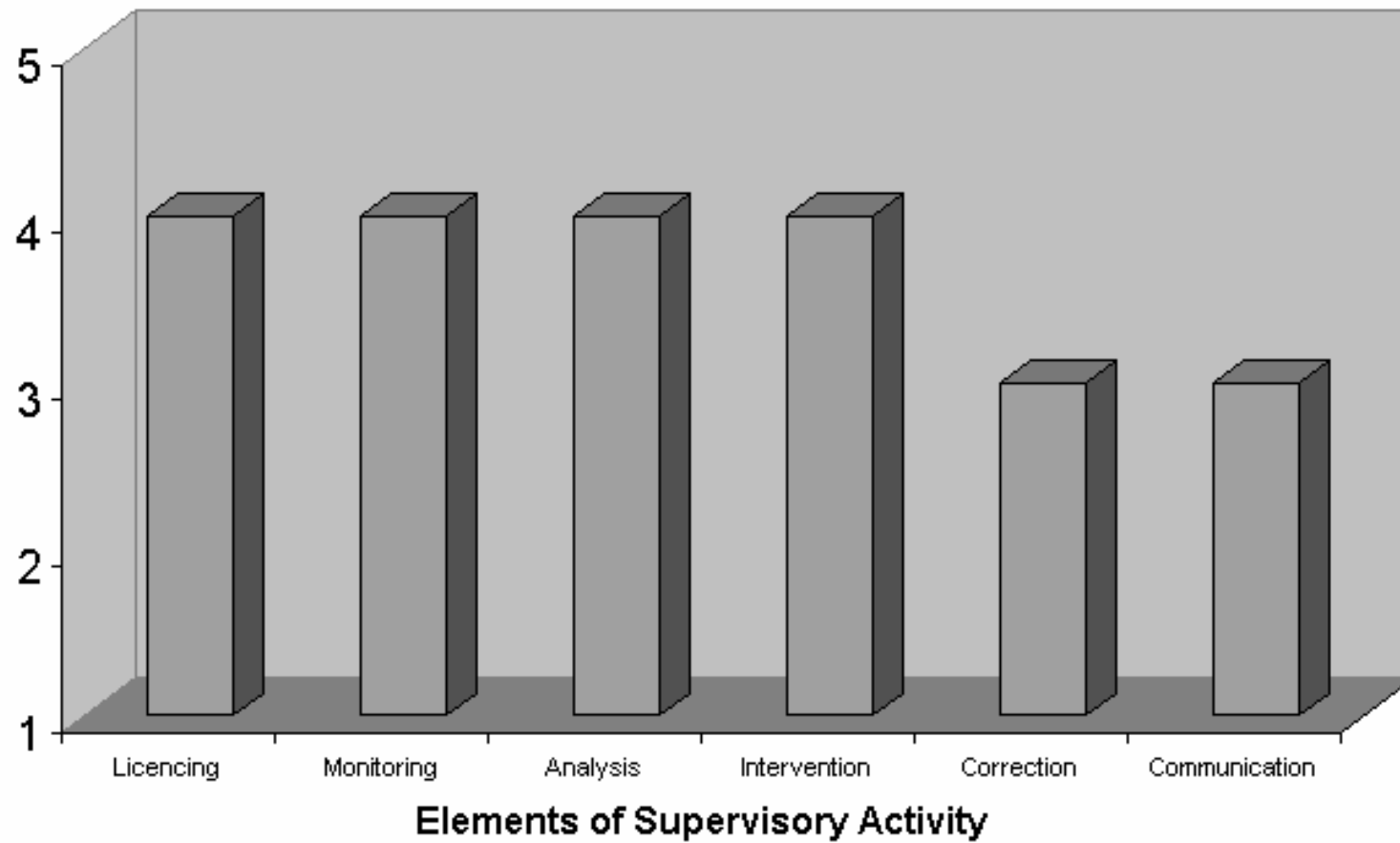
Australia



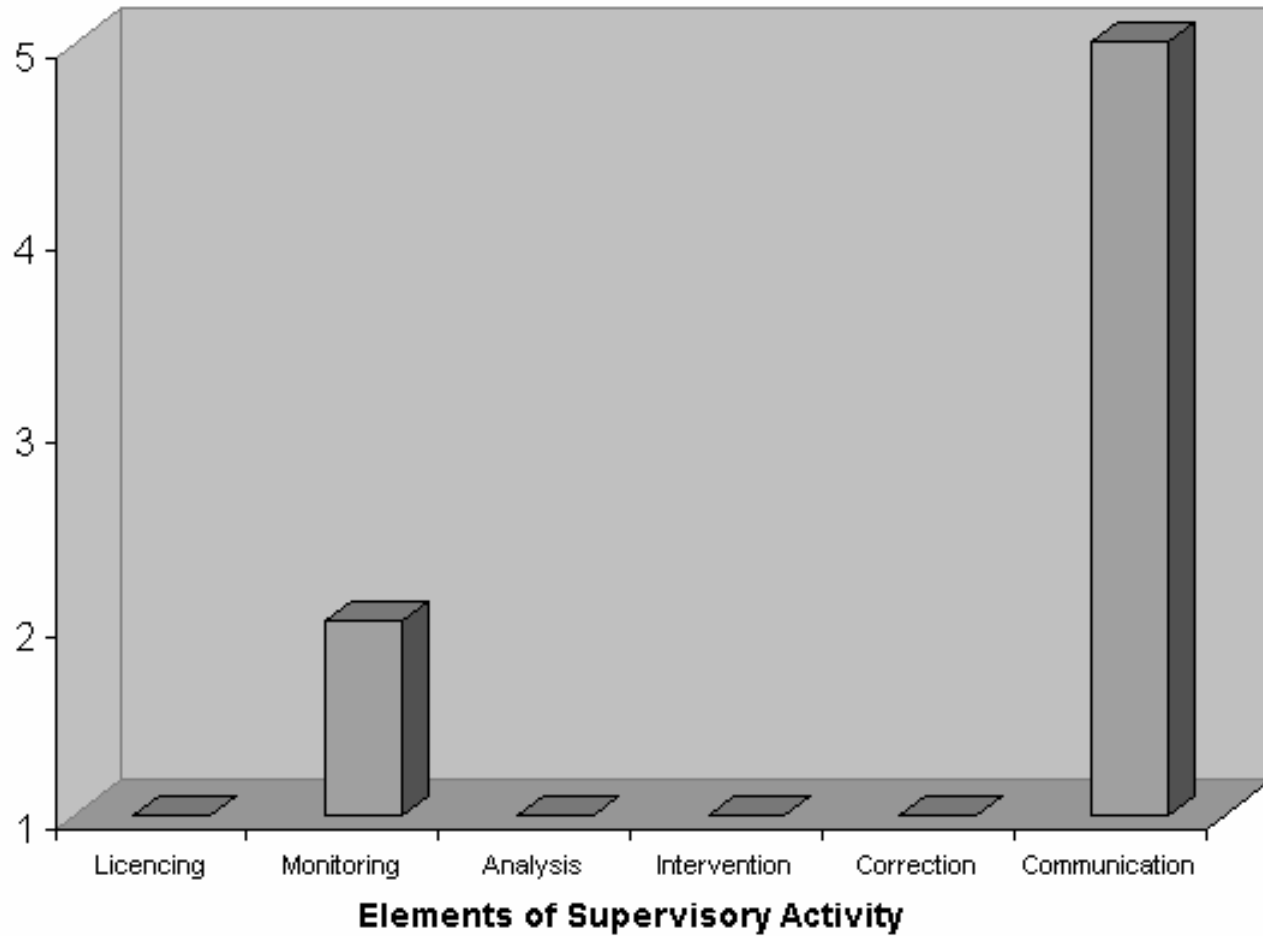
Hong Kong



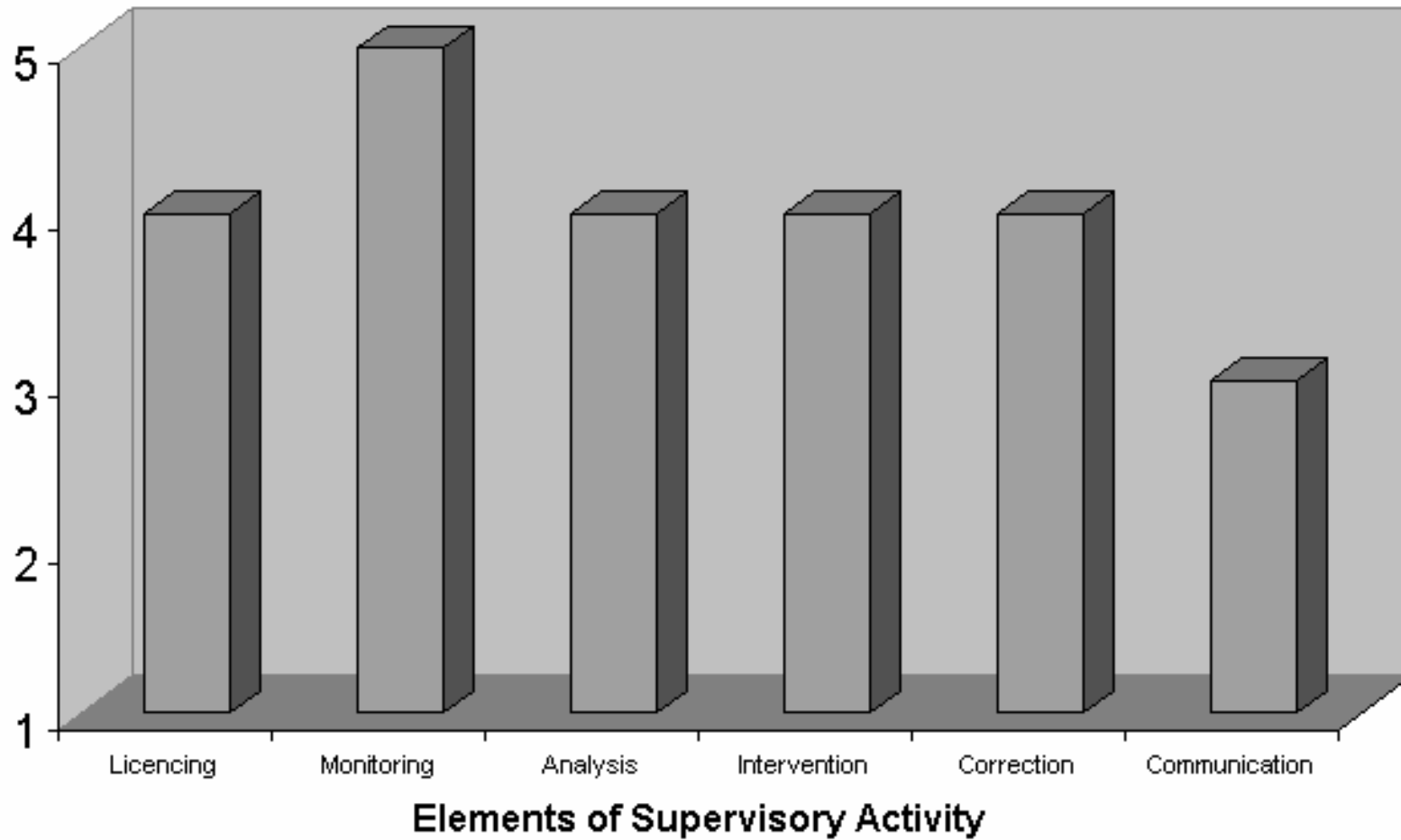
Hungary



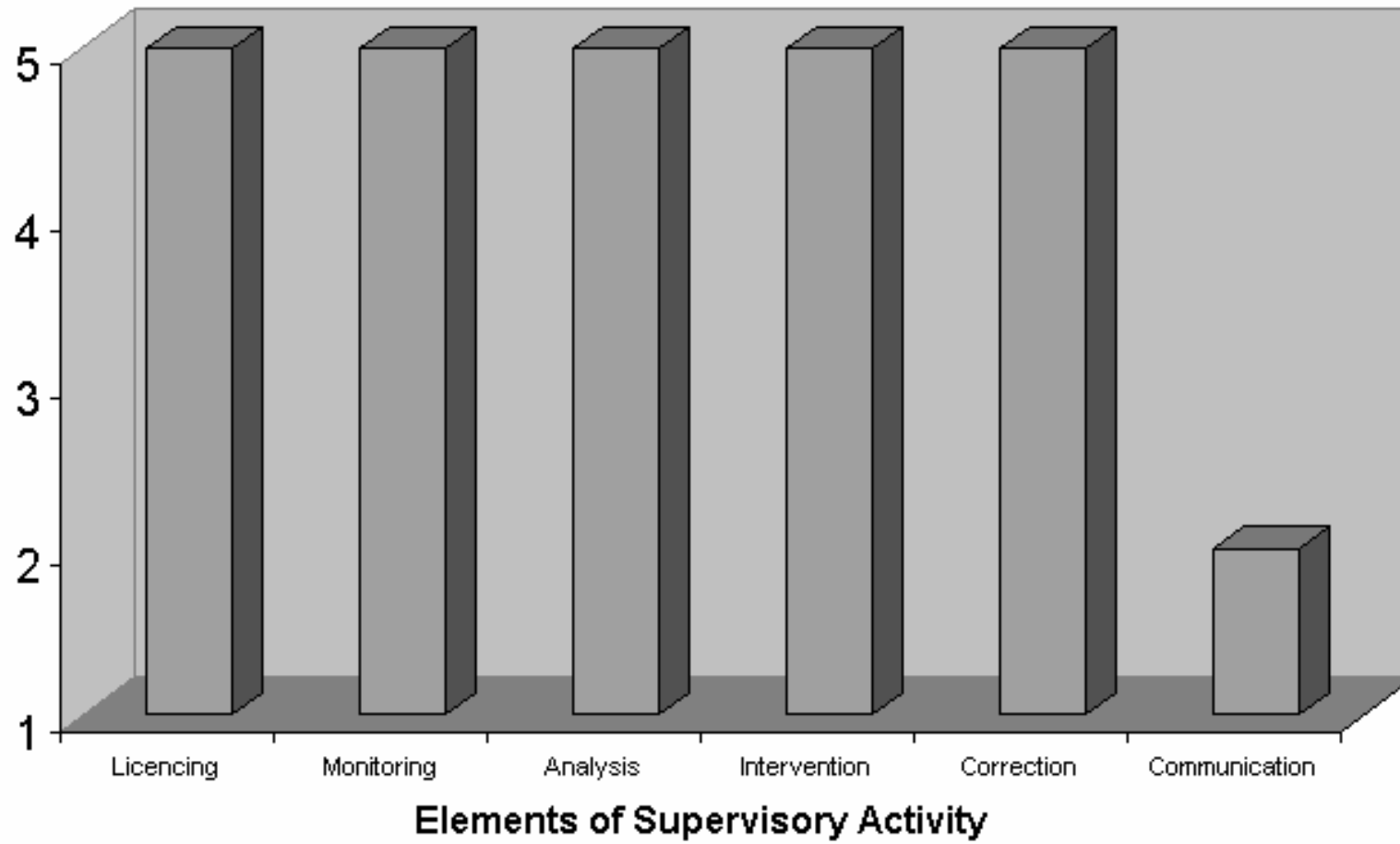
United States



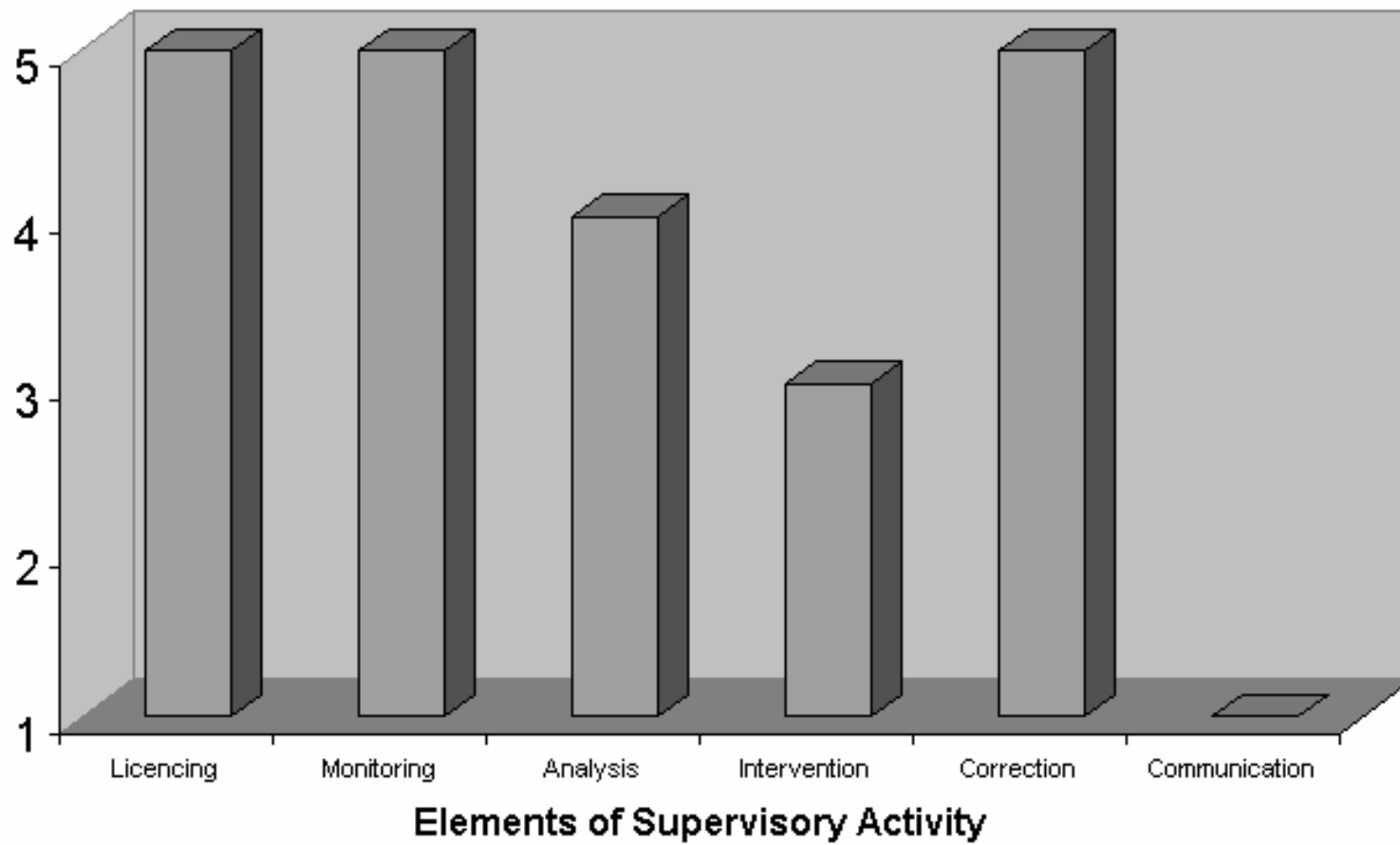
Argentina



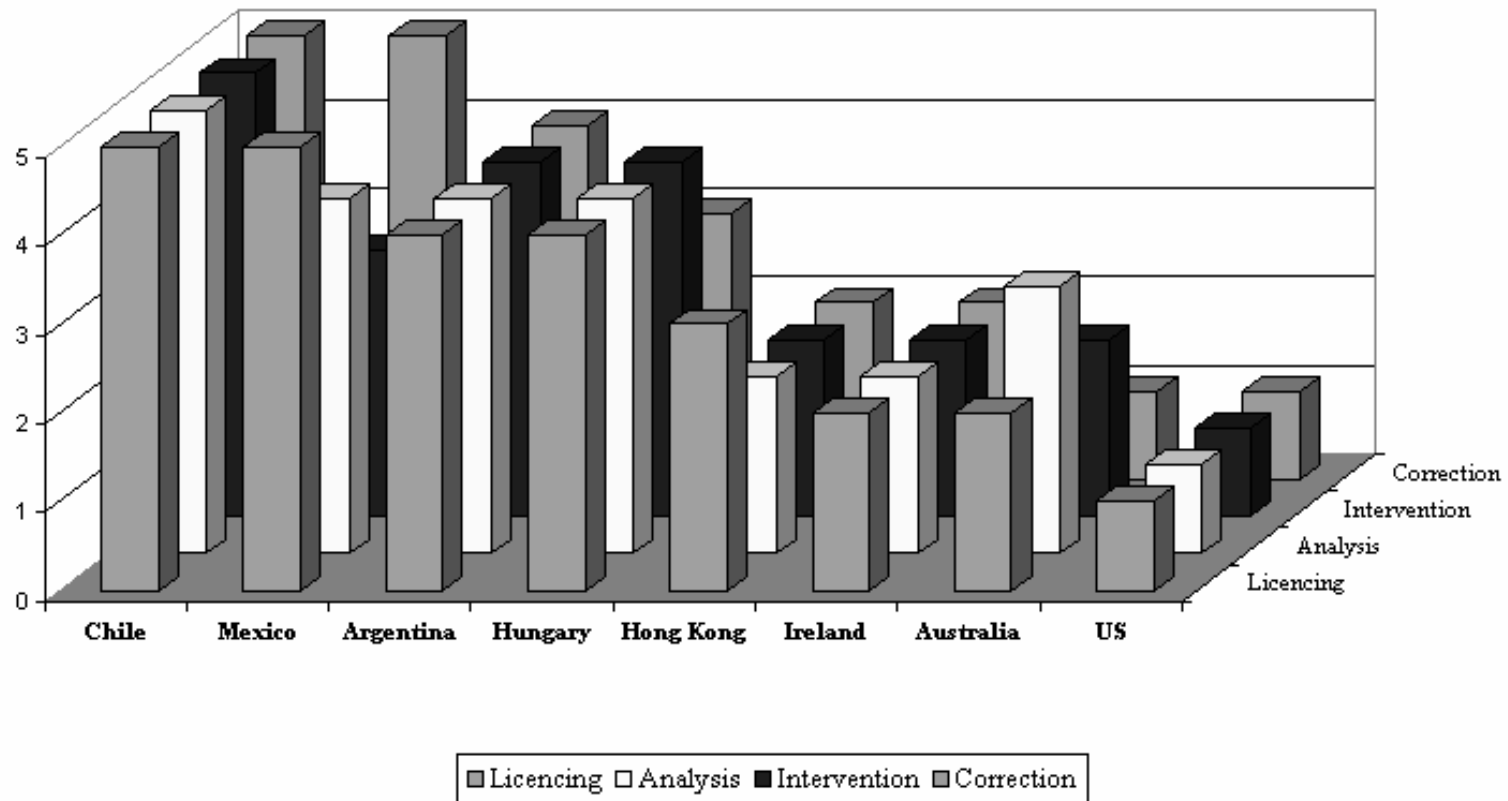
Chile



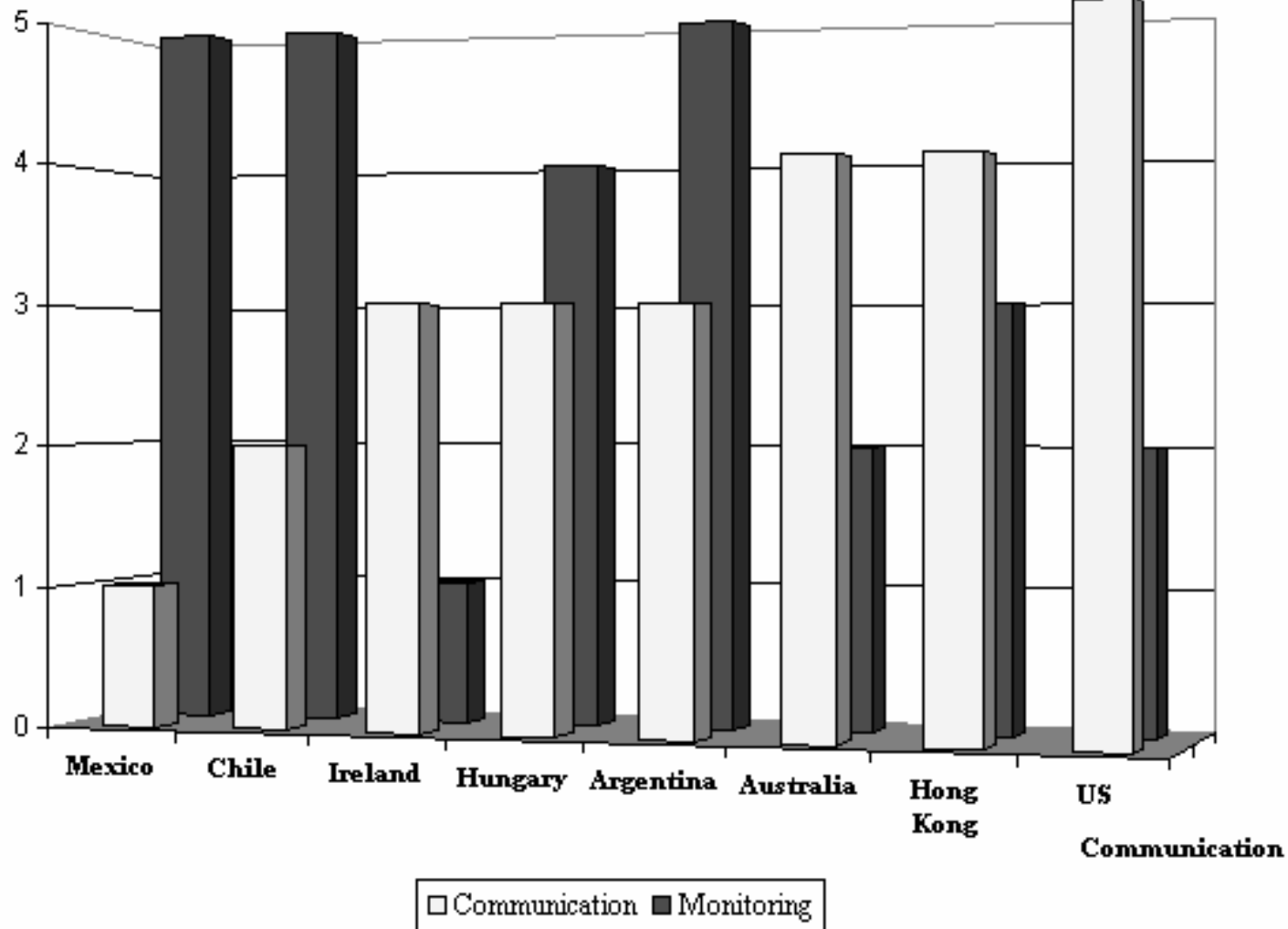
Mexico

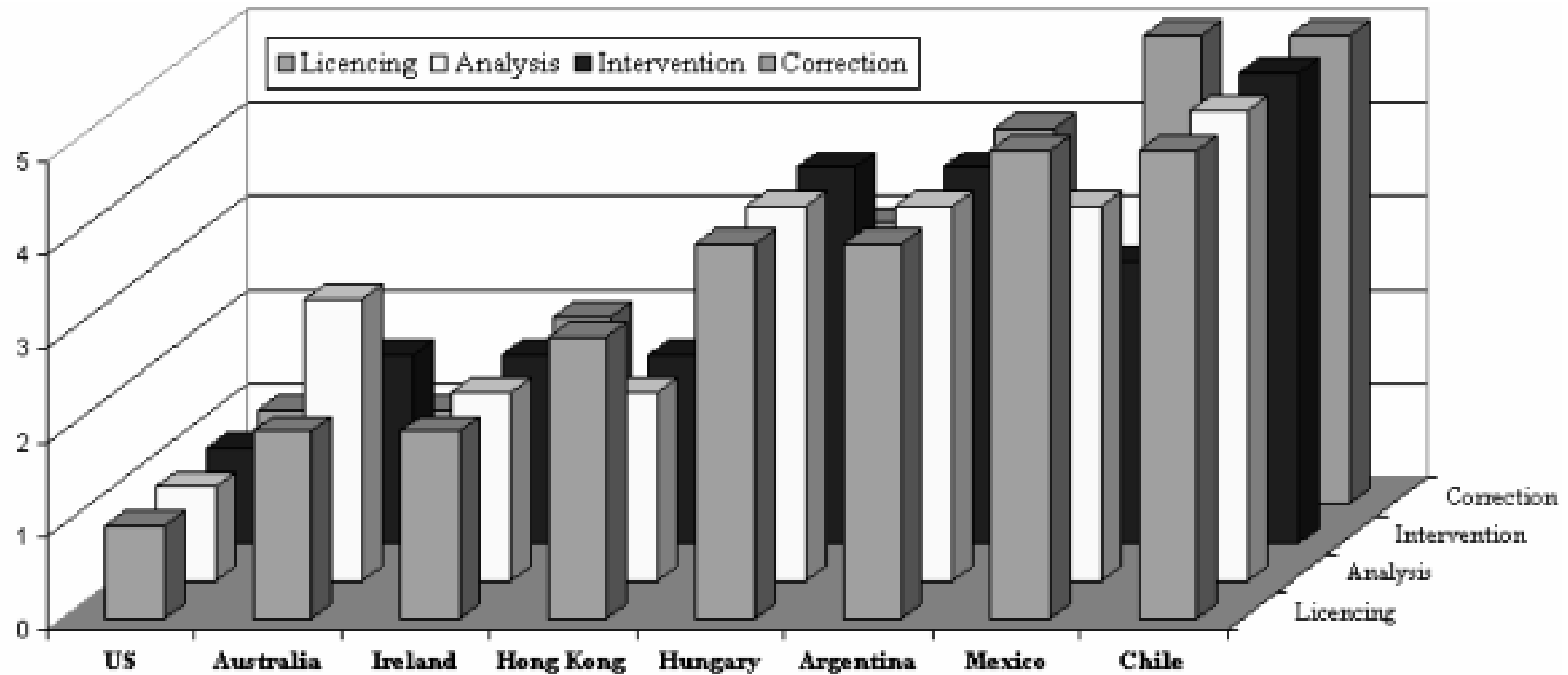


Range of the Intensity of Supervision



Relationship of Monitoring and Communications





Voluntary Occupational

US
Ireland

Mandatory Occupational

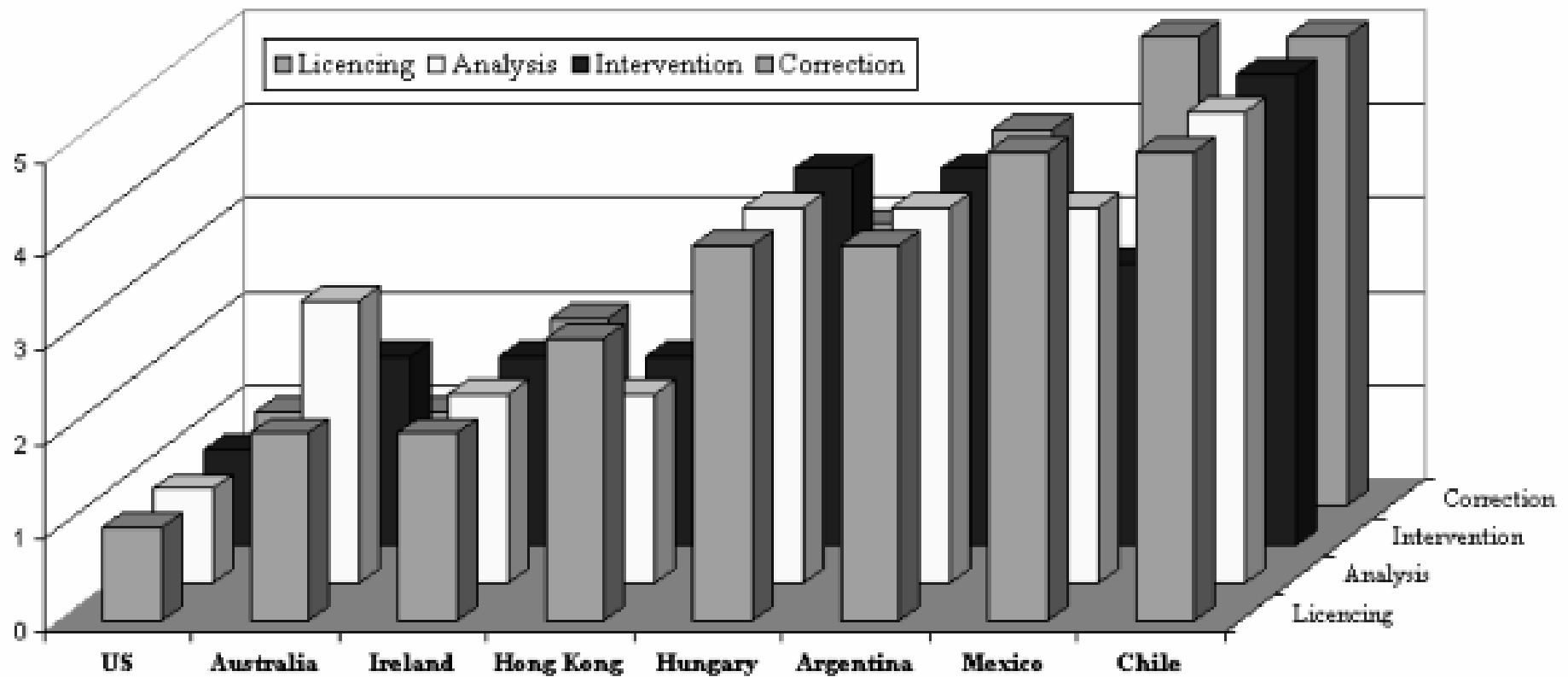
Hong Kong
Australia

Mandatory Personal

Chile
Mexico
Argentina
Hungary

Mandatory Systems Require More Intensive Supervision

- Less Sophisticated Members
- Greater Reliance on Pension for Subsistence
- Fewer Choices – Less Market Discipline
- Voluntary Systems Can Afford Fewer Costs and Require More Flexibility
 - Employer Will Not Enter System If Risks Are Perceived As High
 - Limits of Compensating Differentials – Cost of Monitoring and Intervention Will Not be Absorbed by Members



Over 100,000 funds

US
Australia
Ireland

Under 500 funds

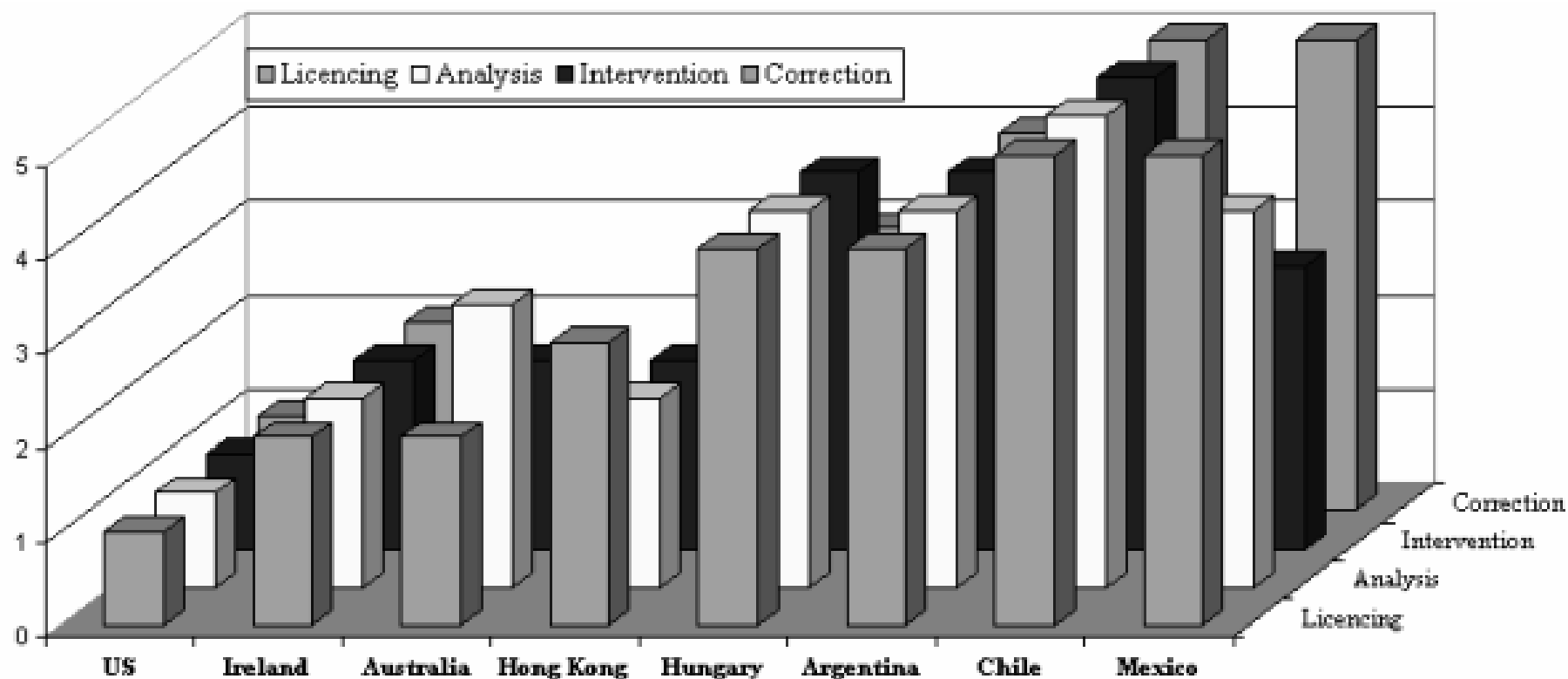
Hong Kong
Hungary

Under 15 funds

Argentina
Mexico
Chile

More Developed Economies and Large Number of Funds Reduces Intensity

- More Sources of Information with Greater Reliability Supports Reactive Approach
- Greater Diversity of Fund Design Limits Potential Intensity of Oversight
- More Flexible and Process Oriented Rules Not Conducive to Directive/Pro-Active Methods
- Greater Reliance on Communication and Competition Improves Efficiency

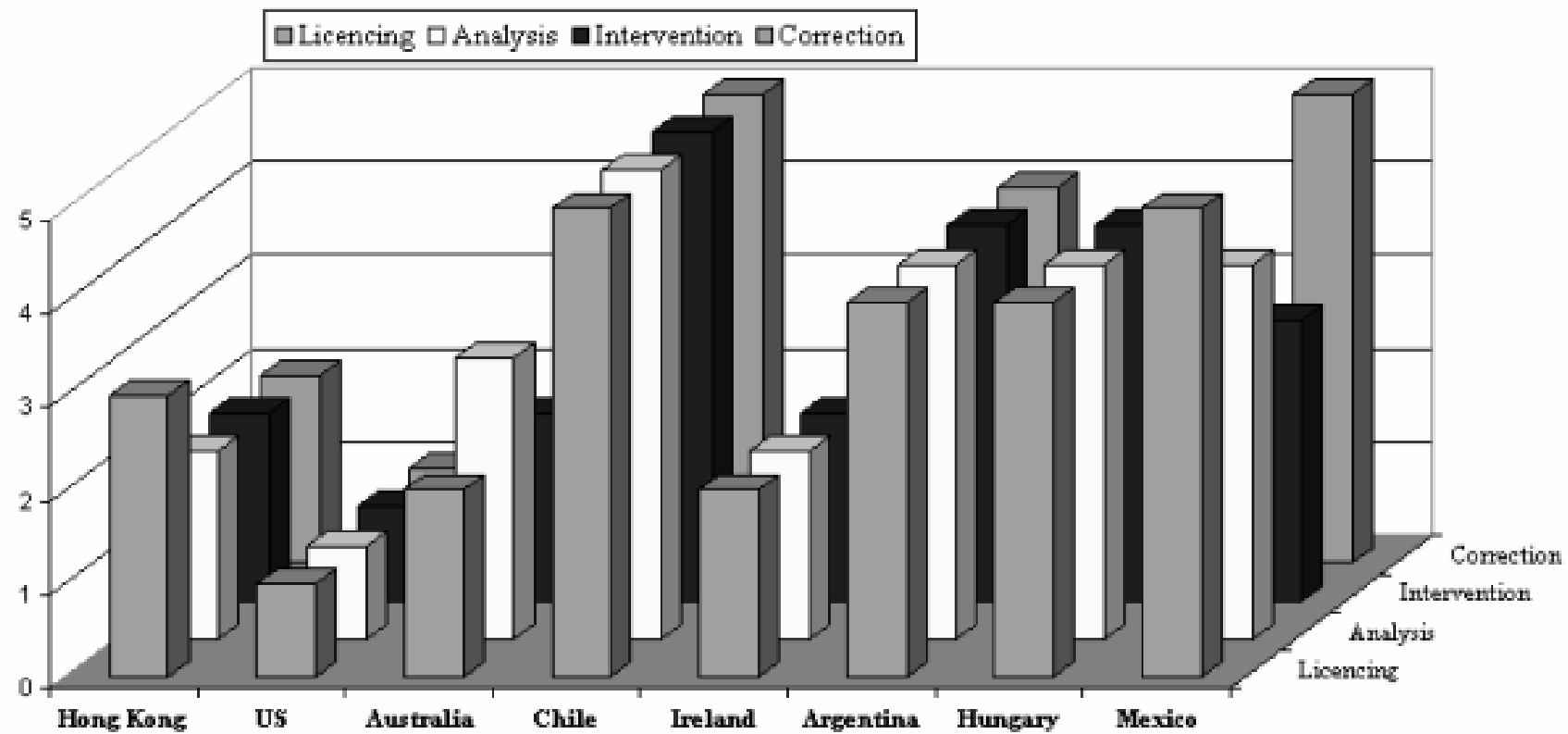


GDP/Head in \$ at PPP							
US	Ireland	Australia	Hong Kong	Hungary	Argentina	Chile	Mexico
\$36,433	\$32,220	\$27,566	\$26,832	\$13,485	\$10,690	\$10,373	\$9,080

Data Source: EIU Country Database. Series form 2002

Higher Incomes Lowers Intensity of Supervision

- Correlates With Presence of Strong Social Safety Net
- Better Capacity of Population To Exercise Individual Oversight – Greater Levels of Financial Literacy
- Lower Share of Household Wealth In Pension System ?



Stock Market Capitalization to GDP

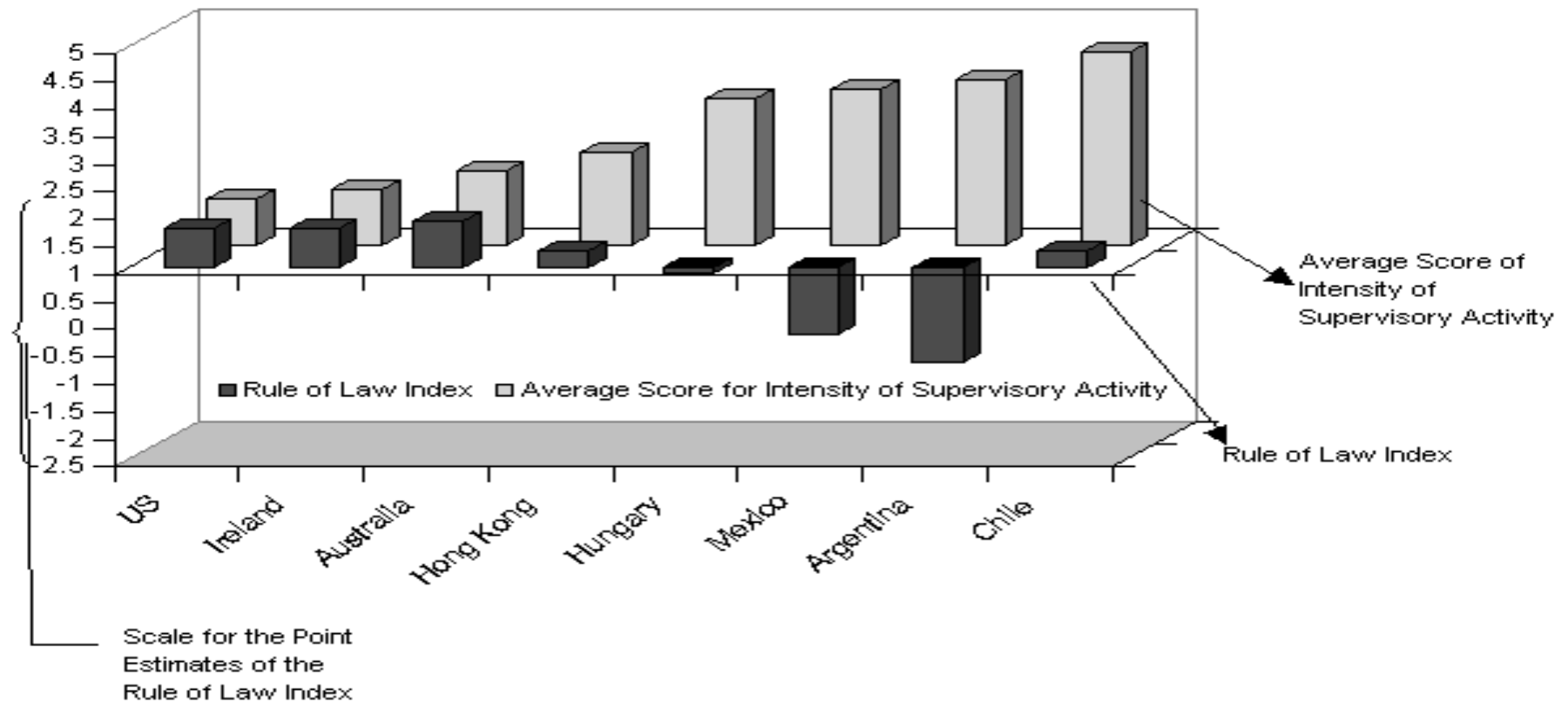
Hong Kong	US	Australia	Chile	Ireland	Argentina	Hungary	Mexico
2.99	1.23	0.86	0.75	0.65	0.19	0.11	0.09

Data Source: Beck, Demirguc-Kunt and Levine

Financial Market Development Facilitates Less Intensive Oversight

- More Products Enhance Competition
- Institutional Development Creates Private Third Party Oversight
 - Financial Accounting Rules
 - Auditors
- Development and Supervision of Financial Professionals Limits Need for Specialized Pension Supervision
- Primary Market Regulation Supports Less Intensive Oversight

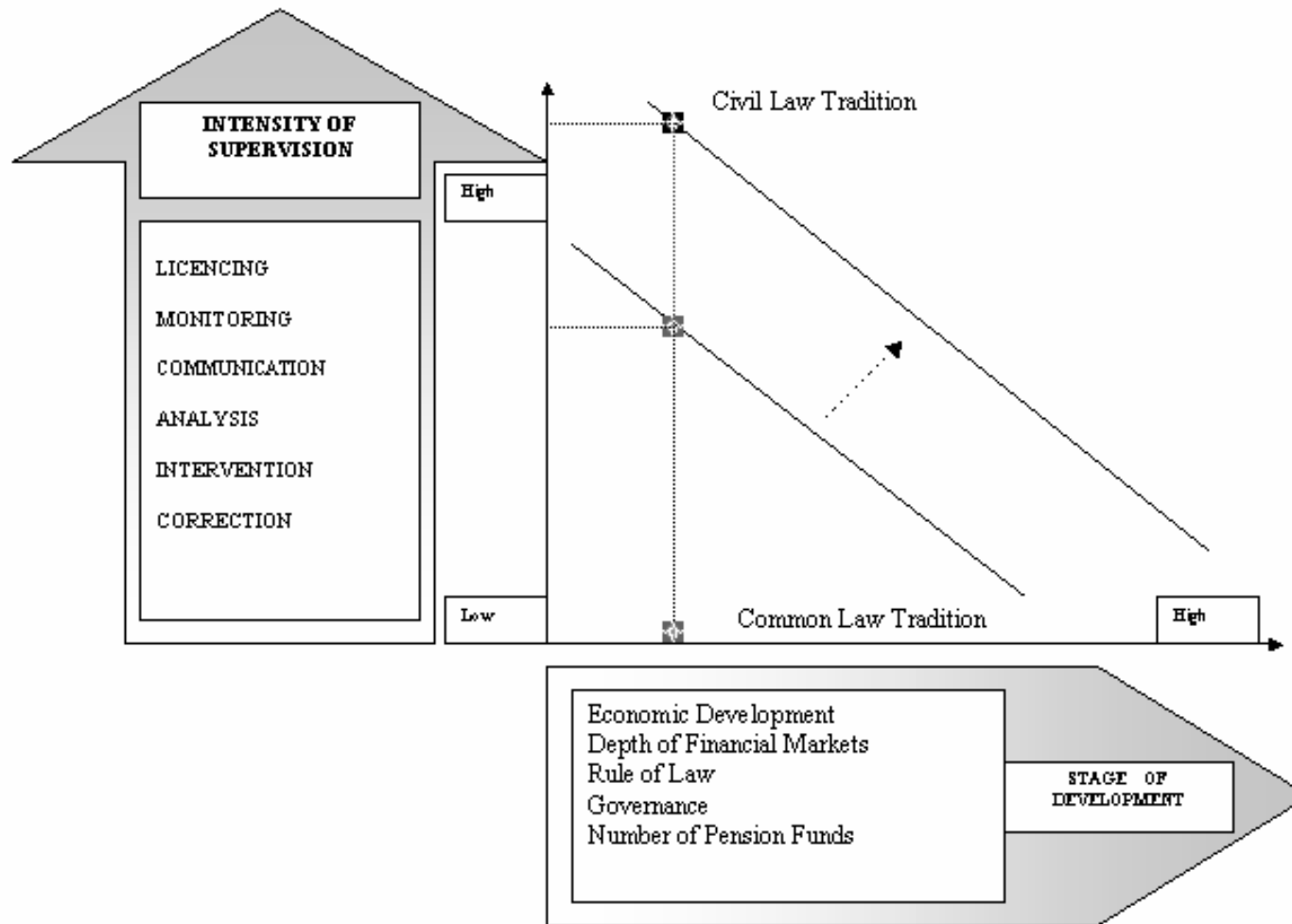
Rule of Law Index and Intensity of Supervision



Enhanced "Rule of Law" Lowers Required Intensity of Supervision

- Greater Capacity for Individual Rights of Action Limits its Need For Supervision
- Capacity to Achieve ex post Remedial Sanctions Diminishes Requirement for Pro-Active Methods
- Greater Reliance on Negotiated Process and Litigation

Some Basic Relationships For Supervision



Concluding Observations

- Indications of Consistent Patterns of Supervision in Relation to Design and Development
- Practices May Be Significantly Derived From Matching Context With Methods
- Complex Relationships Between Design, Regulation and Supervision – Direction of Causality Difficult to Determine
- Effectiveness and Efficiency Require Further Analysis to Support Development of Best Practices Models