Overview of IOPS work on costs

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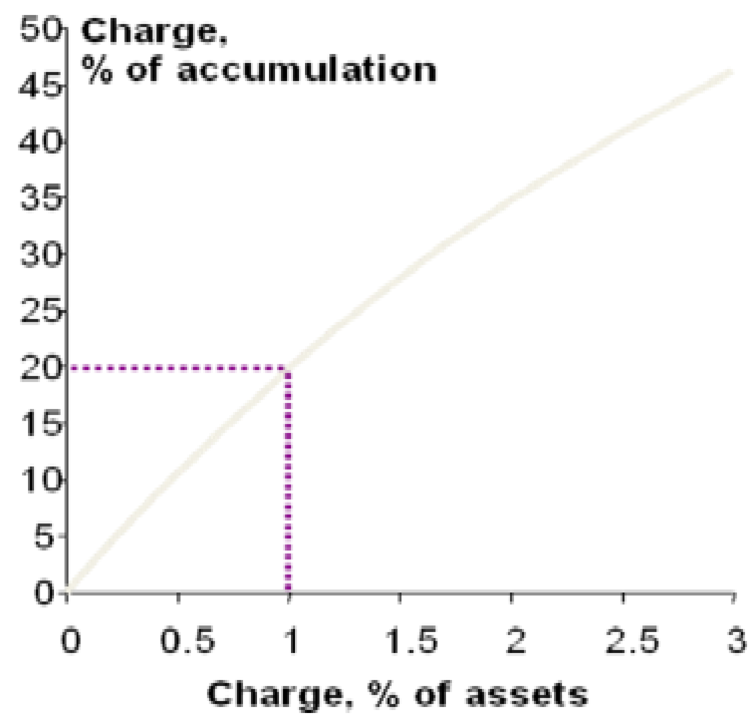
Background

- The fees and charges imposed upon pension funds are of great interest and importance to pension supervisory authorities as they have a significant impact on the amount of retirement income delivered to individuals, particularly in the case of defined contribution (DC) pension schemes.
- 1% charge over 40 years can reduce pension income by 20%



Costs in IOPS Member Jurisdictions

- Costs vary greatly across IOPS Members – e.g. charge on AUM range from over 2% to just 0.2%
- Other charges are also applied in some countries (e.g. on contributions, transfers, exit etc.)
- Competition within private pension systems was expected to drive costs down – but hasn't done so as people pay little attention to their pensions and are price inelastic
- Comparing costs across countries is interesting and useful – in order to try an establish what is driving high costs and what policies can be used to reduce them
- But it is very difficult – as reporting of costs differs therefore not comparing like for like an update on costs and fees

Working Papers on costs and fees

- The first working paper IOPS completed on this subject was WP no. 6 – "Comparison of Costs + Fees in Countries with Private Defined Contribution Pension Systems", June 2008

- Since WP no. 6 was written we have witnessed a serious financial crisis, some pension systems have emerged and others have grown

- IOPS is currently working on an update on costs and fees

Comparing costs and fees

- Due to the great national diversity of systems and fee charging methods, it is extremely difficult to compare such fees and charges internationally.

- In order to contrast administrative fees properly one needs to construct indicators with unifying assumptions, but which take into account all the details in each case, as well as the country-specific wage level.

- Comparisons are made by projecting a value for a DC pension fund accumulated over the working life of the average worker in each country, using a fixed assumption for return on assets. This accumulated balance is then reduced by the charges on fees that each specific country's pension regulation imposes (or which the market in each country sets), thereby allowing for an international comparison.

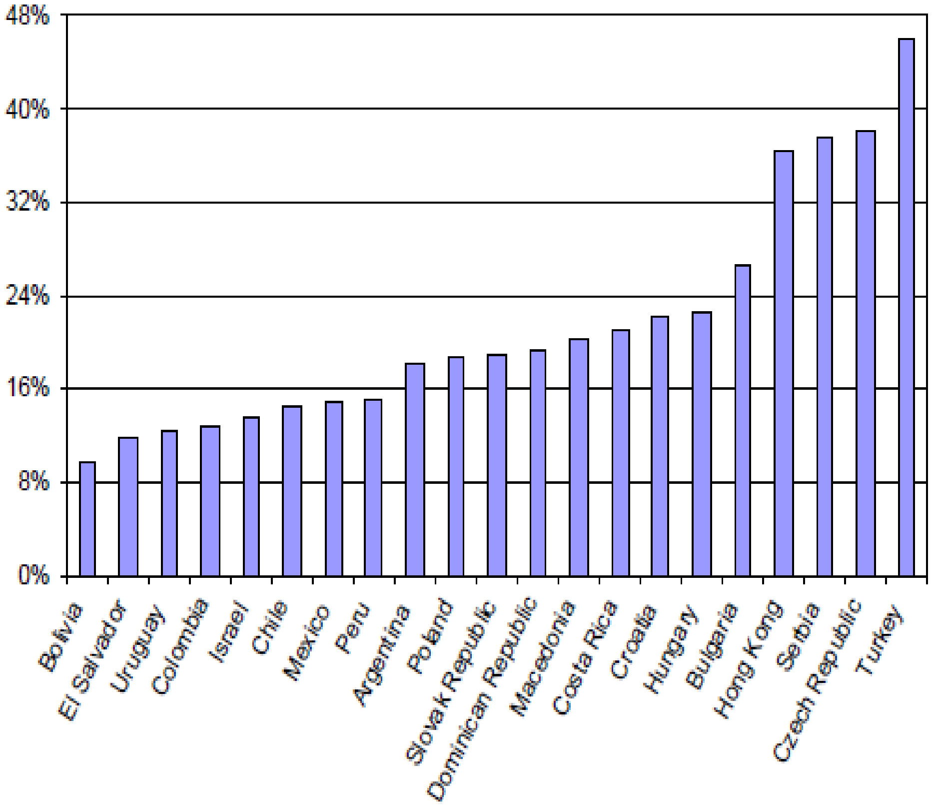
Indicators used for comparability

- ***Charge ratio*** – measures the impact that any type of administrative charge can have on the final balance (for example after 40 years) of an individual retirement account compared to the hypothetical balance that could be obtained if no administrative fees were charged at all. This measure has been used to compare administrative charges in Latin America and in other countries with privately managed retirement savings accounts.

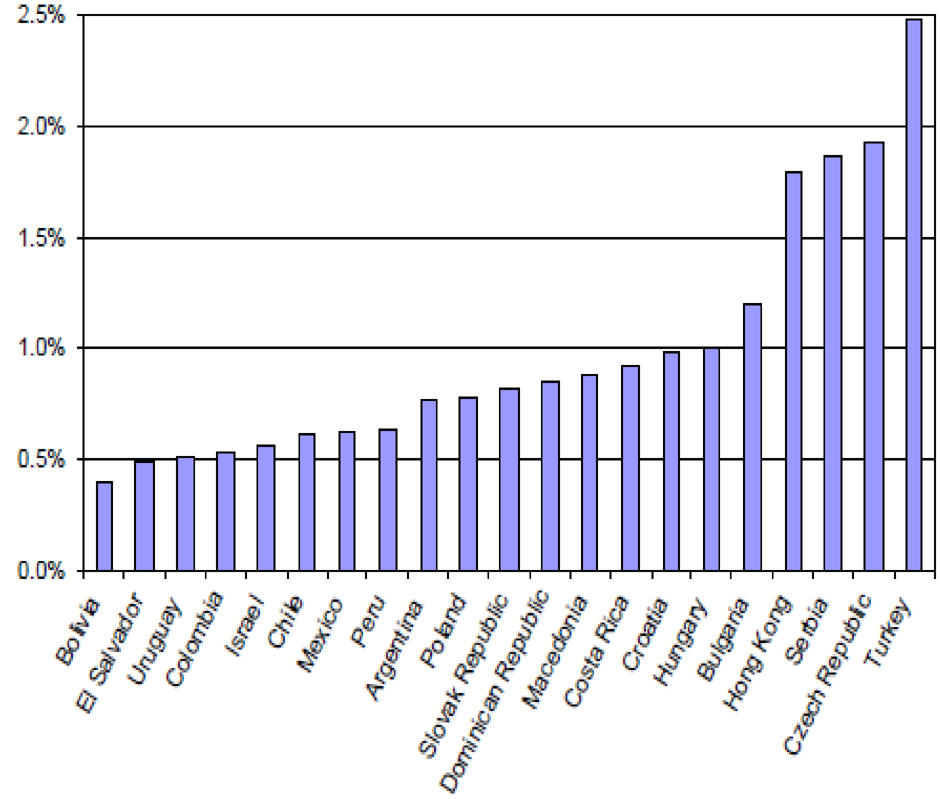
- ***Equivalent fee rate*** – this measure is related to the charge ratio but stated as an annual ratio for comparative purposes.

Results

40 Year Weighted Charge Ratio

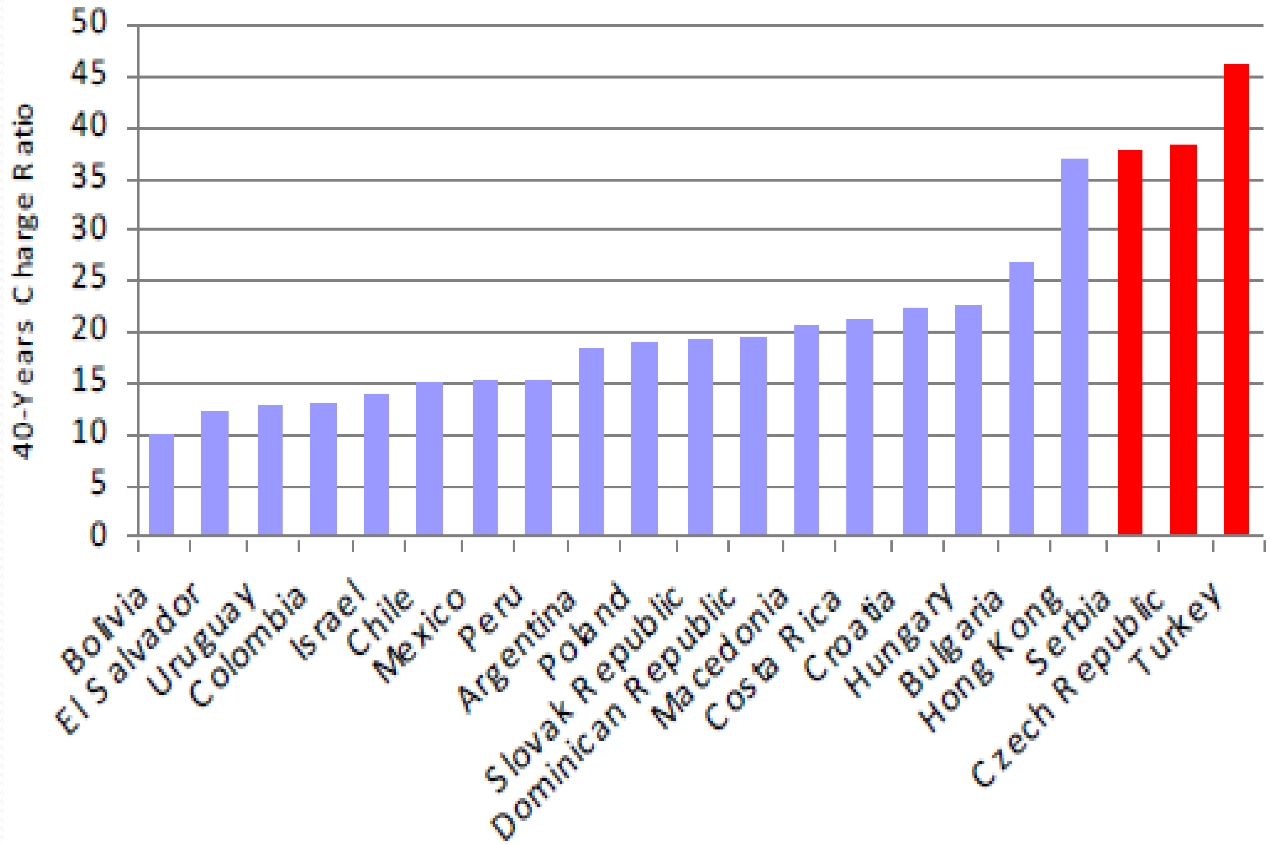


40 Year Weighted Equivalent Fee



Analysis - Exogenous factors

Voluntary systems – tend to be more expensive (e.g. cases of Czech Republic, Serbia and Turkey)



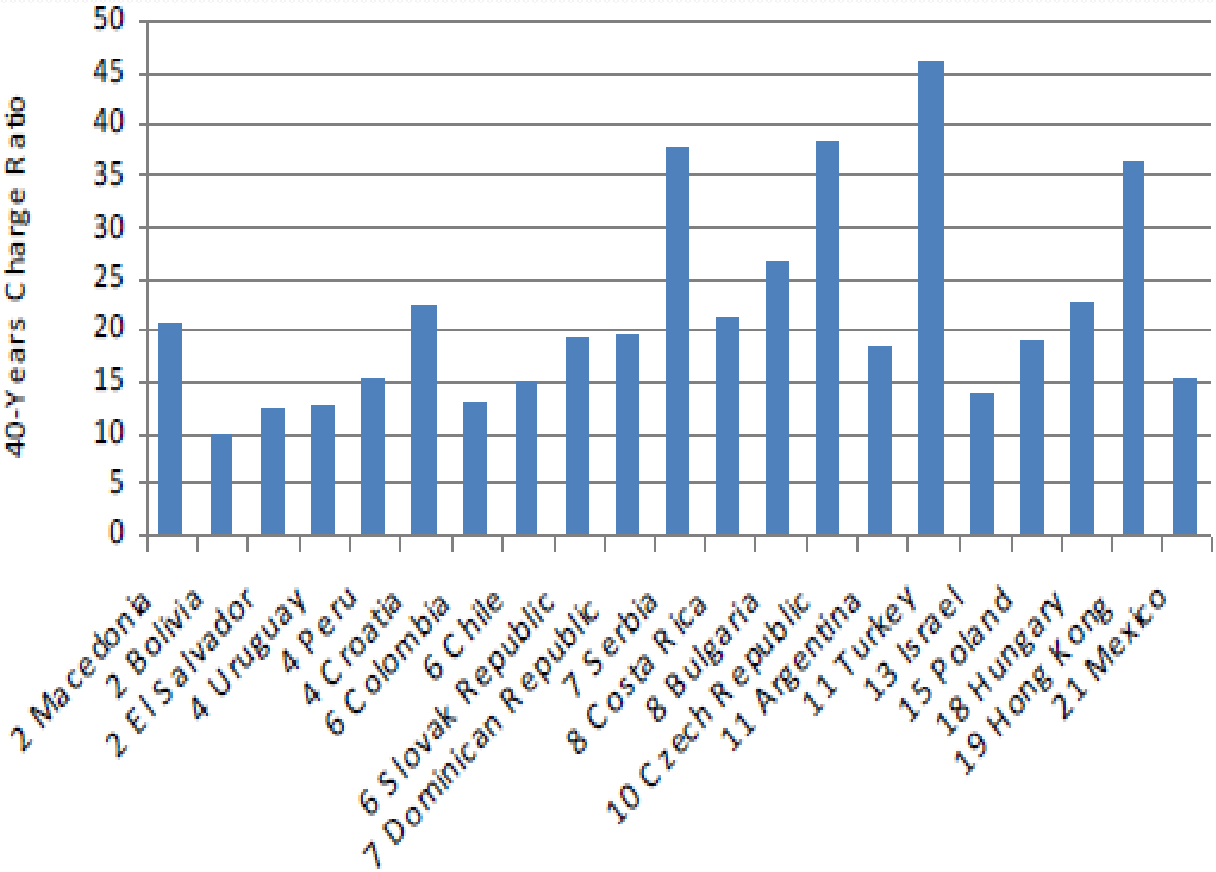
Analysis - Exogenous factors

Ranking by number of providers – the more the providers, the more expensive the system.

The trend is clear, but inconsistent.

Macedonia and Bolivia have with only 2 providers and are relatively cheaper, whilst Turkey and Hong Kong with 11 and 19 respectively, are more expensive.

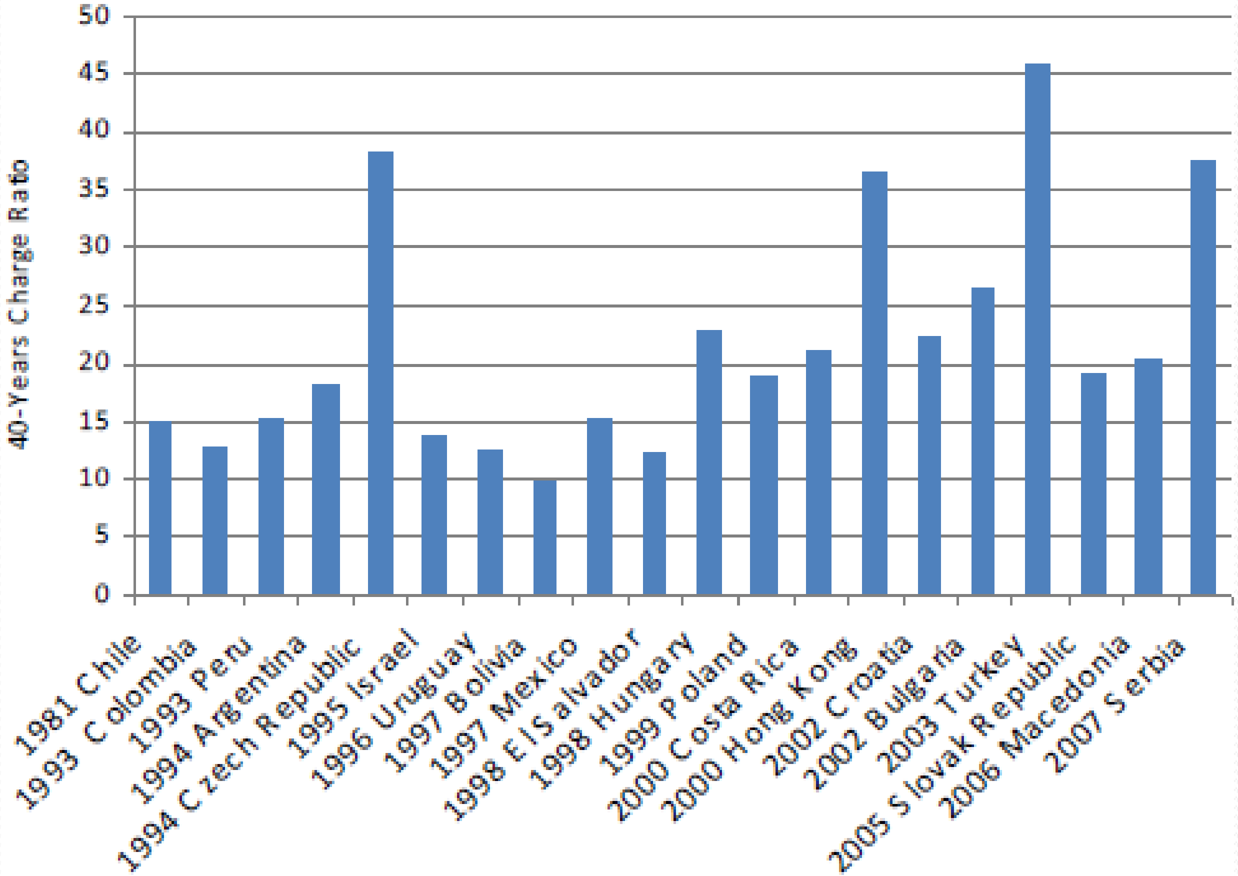
Inconsistencies come from Poland – one of the cheaper countries with 15 providers and Mexico with the highest number of providers, i.e. 21, which are relatively less expensive than Hong Kong and Turkey.



Analysis - Exogenous factors

Ranking by Date System Introduced– it would be expected that the older the system, the cheaper it is. This is the case of Chile and Colombia which are relatively cheaper, while some of the systems set up in Eastern Europe and Asia since 2000 are still relatively expensive and may therefore be expected to decline in future.

Inconsistencies: Macedonia – new, with a relatively average charge ratio and Czech Republic – one of the oldest systems and one of the most expensive.

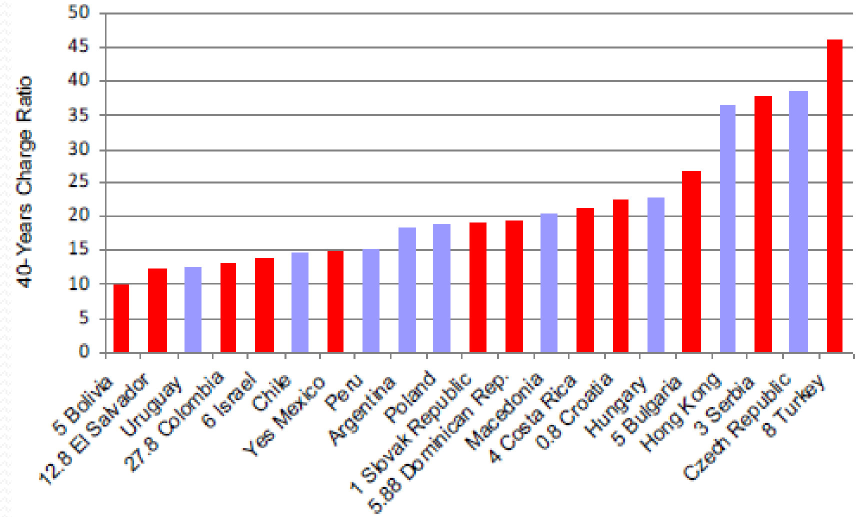


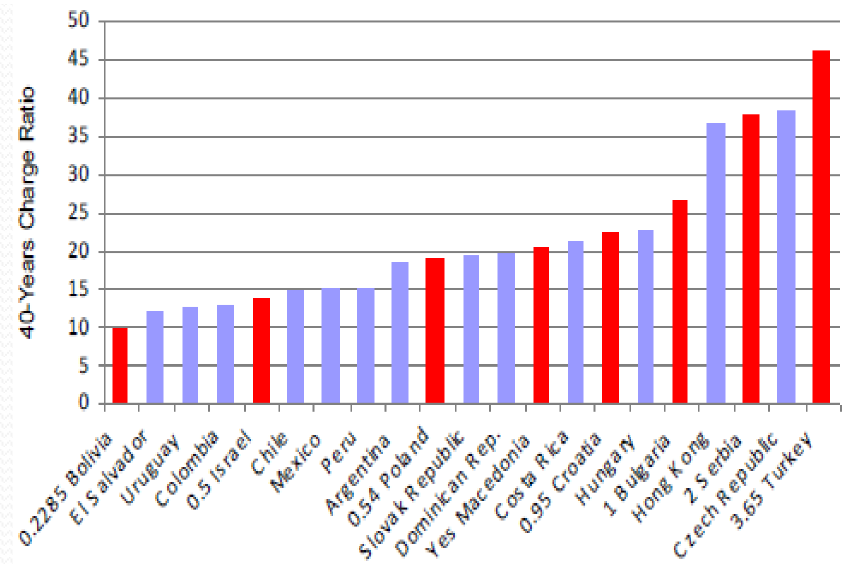
Analysis - Exogenous factors

Legislative restrictions - Croatia and Slovak Republic have low limits on the fees charged (0.8% and 1%), making these countries relatively restrictive. However, they do not rank amongst the lowest charge ratios as the charges on assets under management applied in these two countries are relatively high compared with elsewhere.

On the other hand, Colombia and El Salvador do not impose tight restrictions on flow fees (i.e. 27.8% and 12.8%), yet these two countries rank amongst the lowest charge ratio countries.

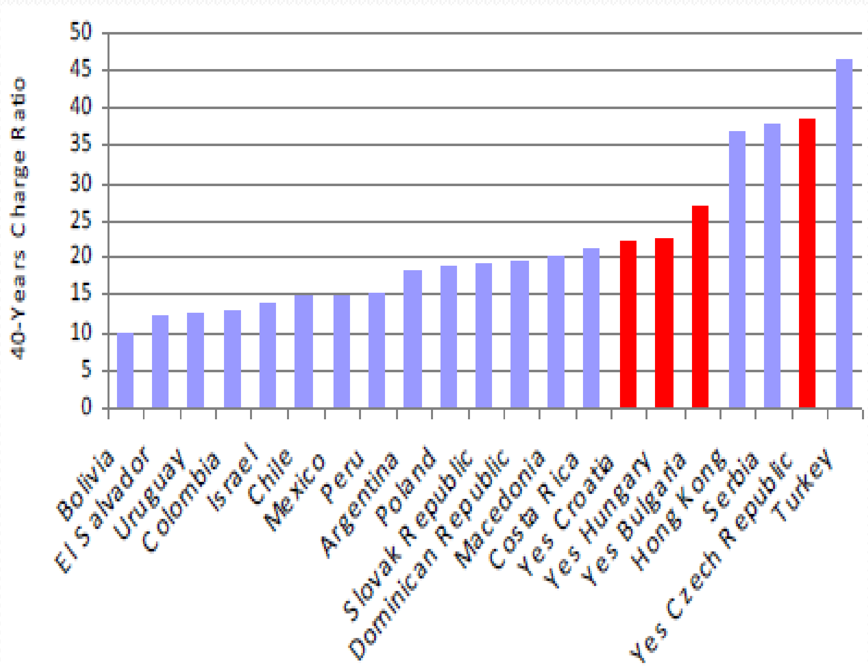
Serbia and Turkey are quite expensive systems.



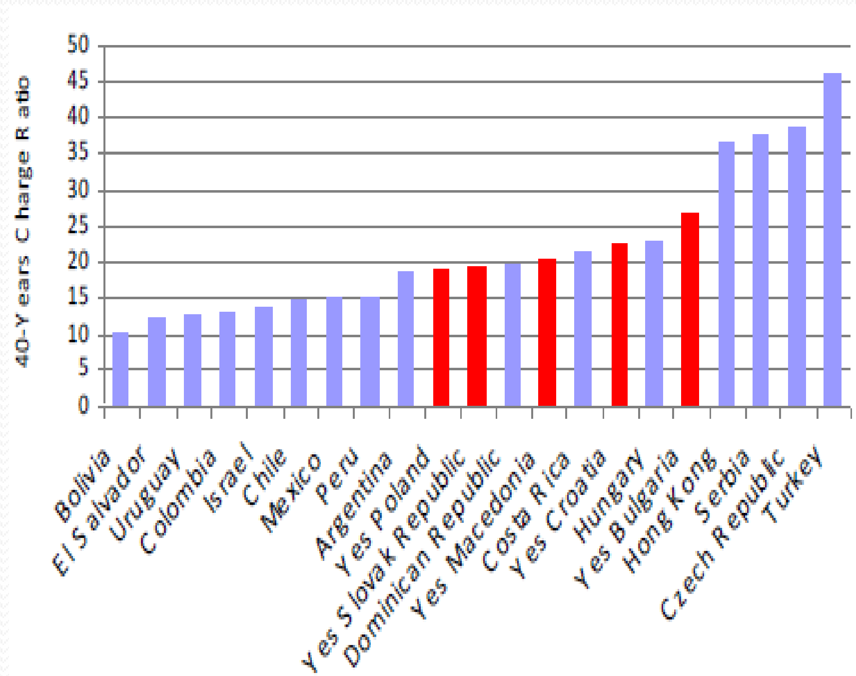


Analysis - Exogenous factors

Minimum Rates of Return Guaranteed

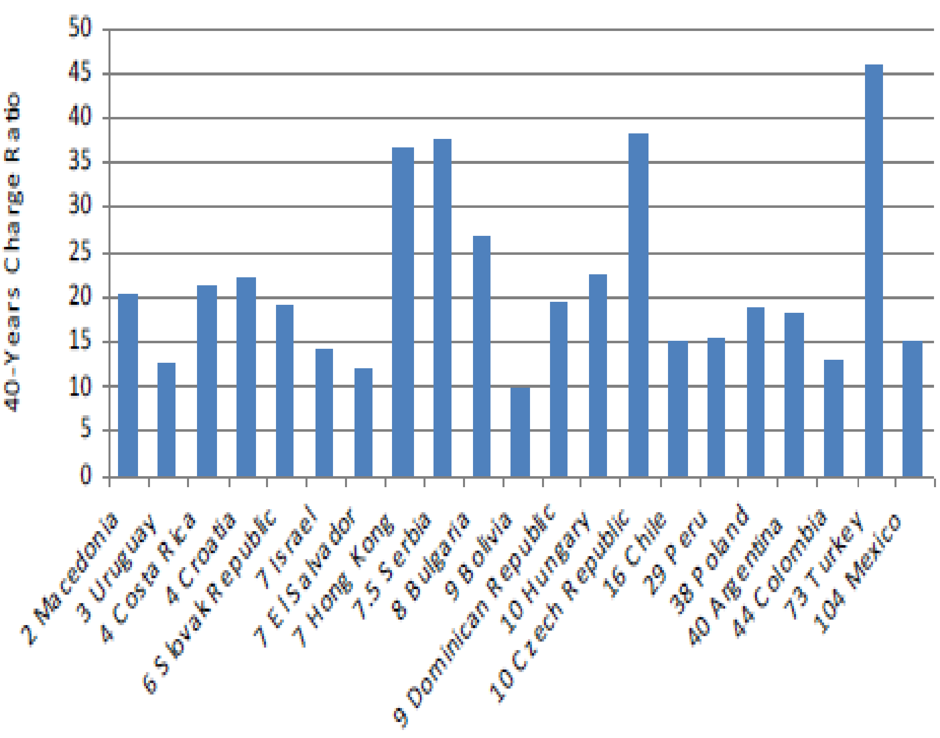


Central Collection

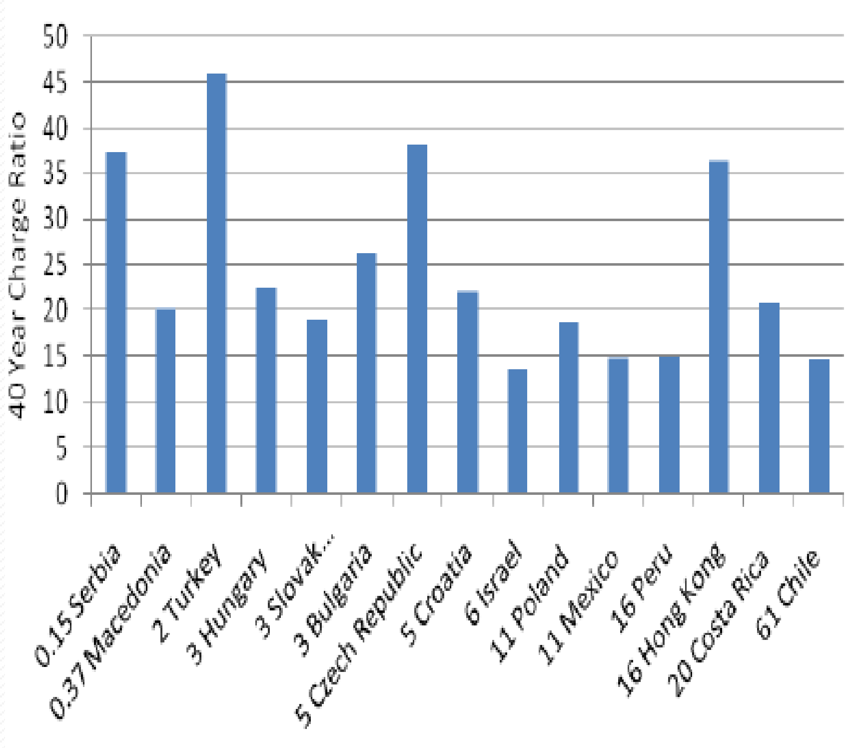


Analysis - Exogenous factors

Ranking by Population Size



Ranking by Assets as % of GDP



Conclusions

- Voluntary systems tend to have higher charge ratios.
- Systems where there is small number of providers, show relatively lower charge ratios.
- Charge ratios decline over time, making older pension systems in general relatively less expensive.
- Regulations, particularly those limiting asset based fees, can reduce costs in pension systems – but opportunity costs (of higher returns) may be sacrificed.
- Regulations imposing minimum guarantees imply higher charge ratios.
- High contribution and wage rates deliver higher final balances and therefore may deliver lower charge ratios.

% Assets Under Management	40 Years Charge Ratio	
	2008	2011
Poland	8.68	8.74
Macedonia	9.09	9.09
El Salvador	11.97	12.62
Uruguay	12.39	13.08
Colombia	12.73	14.27
Israel	13.66	13.44
Chile	14.61	15.53
Mexico	14.87	18.40
Peru	15.01	19.18
Dominican Republic	19.35	24.82
Slovak Republic	21.03	17.43
Costa Rica	21.07	15.01
Croatia	22.21	22.22
Hungary	22.57	19.80
Bulgaria	26.51	26.51
Czech Republic	38.14	39.31
Serbia	37.51	37.67
Hong Kong	40.46	40.46
Turkey	45.88	46.34