



**Oxford University Centre
for the Environment**

**“DC Pension Fund
Design and Governance”**

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1. Introduction

- Defined contribution (DC) benefits have become the 'norm' for occupational pensions
- In the UK, Europe, Australasia and North America
- Either mandatory or voluntary (depending upon the regulatory framework)
- At a time of government discounting of state pension benefits.



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2. Pension Idealism

- In the Anglo-American world, it is underpinned by liberal ideology regarding the autonomy and responsibility of individuals
- Buttressed by strong assumptions about individual rationality
- Being able to distinguish between short-term and long-term interests
- Being effective and informed (literate) 'consumers' of offered pension benefits and products.



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3. The Governance Problem I

- The 'ideal' individual of theory is hard to find in practice
- Shortfalls in reasoning, biases and anomalies, and ever-present temptation confound 'best interests'
- In any event, the costs of information acquisition are significant
- So, one side of the governance 'problem' is the self-governance of the individual plan participant.



4. The Governance Problem II

- On the other side of the equation, plan sponsors are conflicted and self-interested
- Most have an interest in minimising direct costs of plan administration
- Often lack competence in relation to the market for pension services and products
- Rely upon service providers who, in effect, pass-on the costs of pension provision to participants.



5. Confounding Disinterest

- Employers no longer treat DC pension benefits as important in employee reward/motivation
- Hard to demonstrate a link between DC pensions and employee performance and company or institution performance
- Where pension benefits are not valued by younger workers (seeking immediate rewards)
- Where senior corporate officers have other, special pension compensation vehicles.



6. Four Principles of Design

- DC pension institutions should be sensitive to participants' (in)competence and sponsors' ambivalence
- Paying due regard to the economies of scale and scope in the industry
- Being sensitive to the asymmetries of information between the purchasers and the providers of pension services
- While providing a cost-effective and 'adequate' supplementary pension.



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7. The Design Challenge

- Actually, the challenge is more subtle than the 4 'principles' noted above
- In fact, participants in any plan tend to vary by socio-demographic status and interests
- As well, there is evidence of quite different levels of competence and commitment between participants
- A 'universal' solution may not provide much more than a basic or minimum benefit for those who might expect much more.



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8. Governance Solutions I

- In the first instance, the sponsor, its plan board, and plans' senior officers should be subject to a 'test' or 'tests' of commitment
- It could be fiduciary duty
- It could be through 'skin-in-the-game'
- It could be through contract and performance, etc.

At present, many sponsors are 'silent' on this issue although the US courts are increasingly sensitive to lack of commitment.



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9. Governance Solutions II

- As for participants, what comes first? Autonomy or paternalism?
- Evidence on behaviour suggests paternalism should come first
- But the evidence also suggests that there should be options for 'structured-choice' and 'open-choice'
- Based upon implicit or explicit tests of attention and willingness-to-learn via the hierarchy of choices.



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10. Over-sight on Governance

- It is vital that there be an 'active' governance policy in DC plans – independent and self-critical
- Should it be an issue of 'best-practice' or an issue of regulation and judicial over-sight?
- It is also vital that there be 'active' over-sight of plan participants' choices and decisions (within the environment of structured-choice and open-choice)
- Should that be an issue of 'recording' behaviour or 'intervening' in behaviour?



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11. Public Utilities I

- Given employer disinterest and employee lack of competence, one option may be to create 'public utilities' for pension saving
- Arguable that this is what occurred in Australia, and the UK NEST is the latest incarnation
- Based upon the 4 'principles of design' (slide 6)
- Assuming economies of scale and scope are realised and governance problems are effectively managed.



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12. Public Utilities II

- Nonetheless, there are three challenges that face any 'public utility'
- First, providing a level of service consistent with the variety of actual and potential participants – their interests and competencies
- Second, managing plan infrastructure both with respect to current needs and future needs (an issue of innovation)
- Third, distinguishing 'plan' performance from its private competitors (actual and potential) such that pension outcomes are not a "lottery" (OECD 2010).



13. Conclusions

- DC Pension provision is at the cross-roads – there is evidence of employer-retreat in many jurisdictions
- If our manifesto for ‘best-practice’ were adopted, even more would be expected of sponsors in terms of their commitment and governance
- Our exemplars demonstrate that ‘commitment’ creates real dividends for participants in terms of pension adequacy (value-to-money)
- But if we want high coverage rates and best-practice we may have to rethink the role of employers in relation to the alternative models.



14. References

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