Regulating private pension funds’ structure, performance and investments: cross-country evidence


Abstract

A number of countries have introduced individual, privately managed defined-contribution accounts, where the value of the pension benefit will depend on accumulated contributions and investment returns. These schemes expose workers’ future pension benefits to a number of different risks. To try to mitigate these risks, reforming governments have often strictly regulated the pension fund management industry’s structure, performance, and asset allocation. Structural regulations often force workers to choose only one manager and one fund. So, workers are unable to diversify investments across funds, exposing them to aberrant behaviour by fund managers, and preventing portfolio adjustments according to the individual’s age, household characteristics, career profile and attitude to risk. Strict asset-allocation rules and relative performance criteria mean that pension funds often invest and perform almost identically, removing any substantive choice for workers over the allocation of their pension fund’s assets and the portfolio’s risk and returns. Concentration in the pension fund management industry is found to be higher in the new pension systems of Latin America and Eastern Europe than in most OECD countries. Concentration might be because the new pension markets are smaller than in countries with more established funded pension systems, but it could also be because of restrictions on industry structure. In Latin America, asset allocation and performance is nearly identical across pension funds. So-called ‘herding’ behaviour is almost a defining characteristics of these pension regimes. Again, this reflects, at least in part, asset allocation restrictions and strict performance regulation. There is also evidence that pension funds have often under-performed simple portfolios composed of market indices of stocks and bonds. All the rules imposed in the new systems of Latin American and Eastern Europe seem to be more stringent than in the OECD, with one exception: portfolio limits. Some OECD countries have a tighter investment regime than countries such as Argentina, Chile, Colombia, Peru and Poland. But OECD countries tend to have fewer barriers to entry and impose fewer constraints on performance than Latin American and Eastern European countries.

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References:


Pension Fund Board Composition and Investment Performance: Evidence from Private Equity.
We examine the governance of public pension funds and its relationship to investment performance.
Pension fund board composition – most often set by statute many decades earlier – is strongly related to the performance of private equity investments made by the fund. Funds whose boards have high fractions of members who either sit on the board by virtue of their position in state government (ex officio) or were appointed by a state official underperform the most, followed by funds whose boards have a high fraction of members elected by participants.