Pension Regulation

Mike Orszag

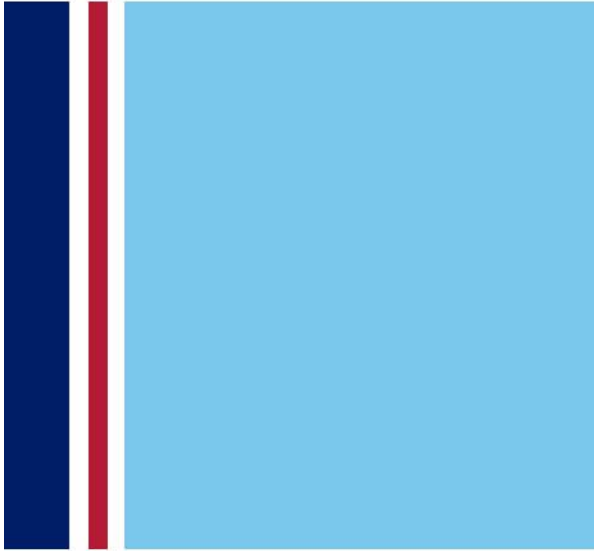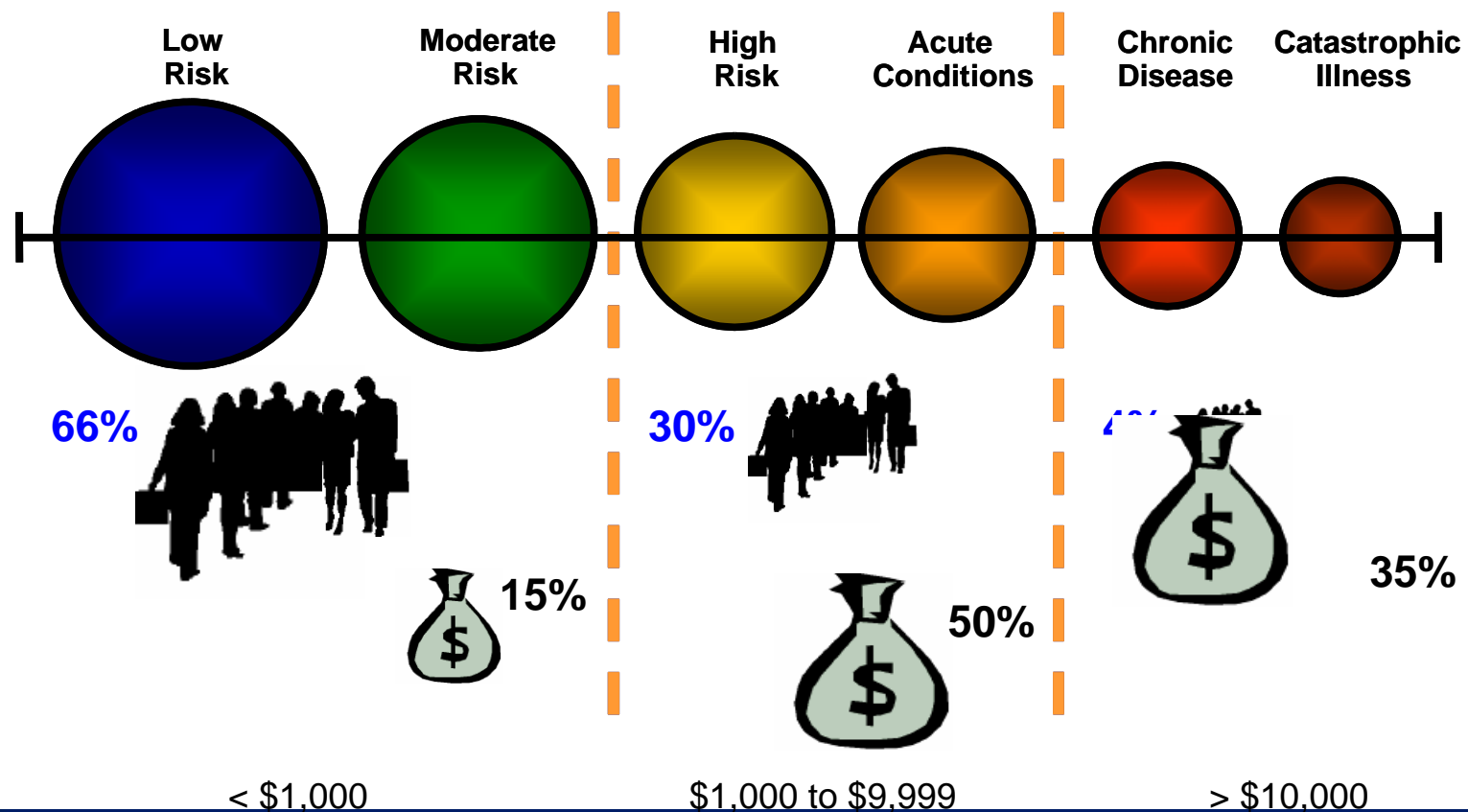**Watson Wyatt** *Worldwide*

Issues

- DB vs. DC
- Employer-provided vs. Financial institutions
- Regulatory/supervisory vs. Consumer protection

Health Insurance in the US
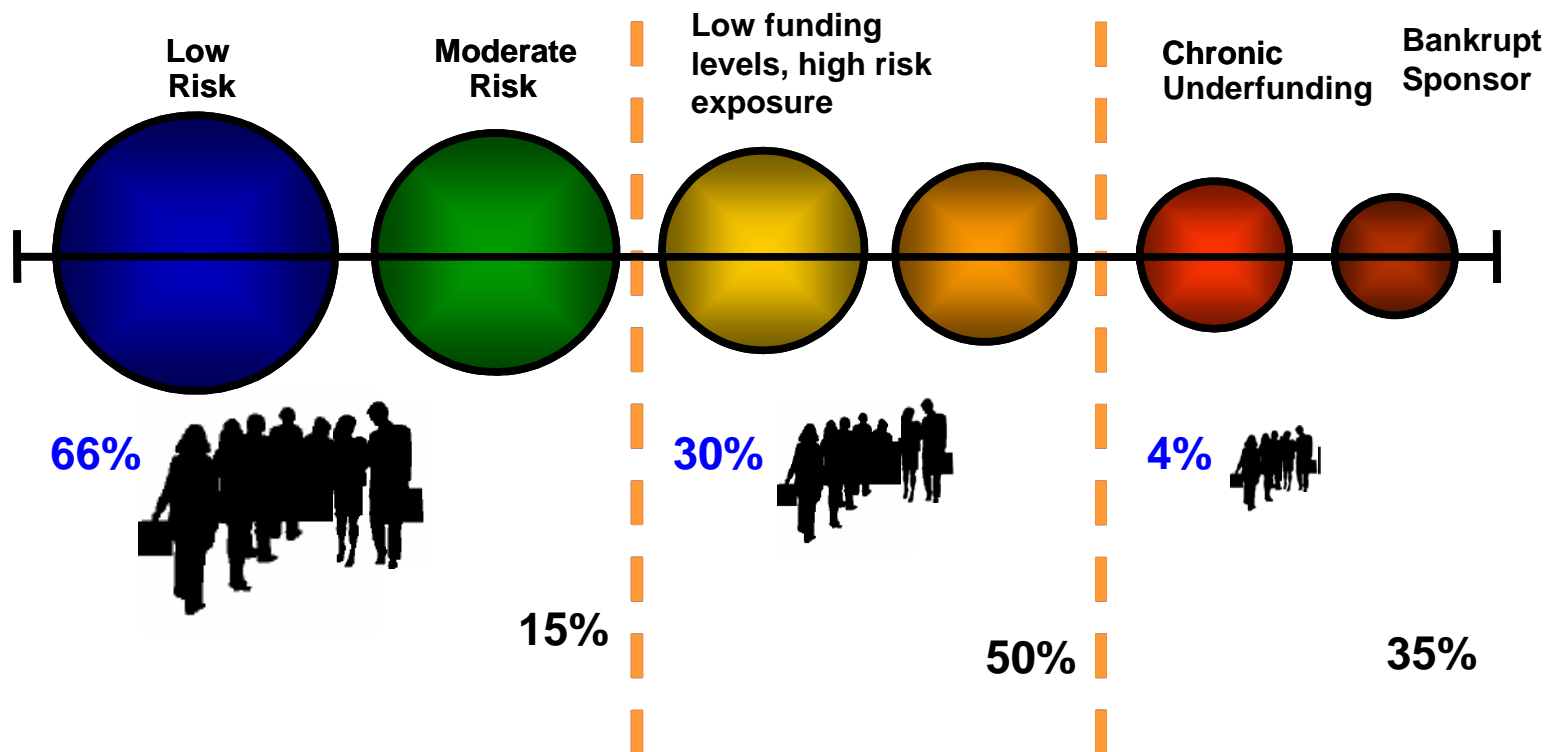
Typical Employer Covered Population

Low Risk	Moderate Risk	High Risk	Acute Conditions	Chronic Disease	Catastrophic Illness

66%

15%

30%

50%

35%

< $1,000 $1,000 to $9,999   > $10,000

Pension Funds

Exposure to risk

Low Risk

Moderate Risk

Low funding levels, high risk exposure

Chronic Underfunding

Bankrupt Sponsor

66%

30%

4%

15%

50%

35%

Funding Ratios, US and UK firms

Distribution of Funding Ratio: U.S. Firms 2003–04

967 observations

Distribution of Funding Ratio: U.K. Firms 2003–04

391 observations

Watson Wyatt Worldwide

Distribution of Equity Share: U.S. Firms 2004

546 observations

Distribution of Equity Share: U.K. Firms 2004
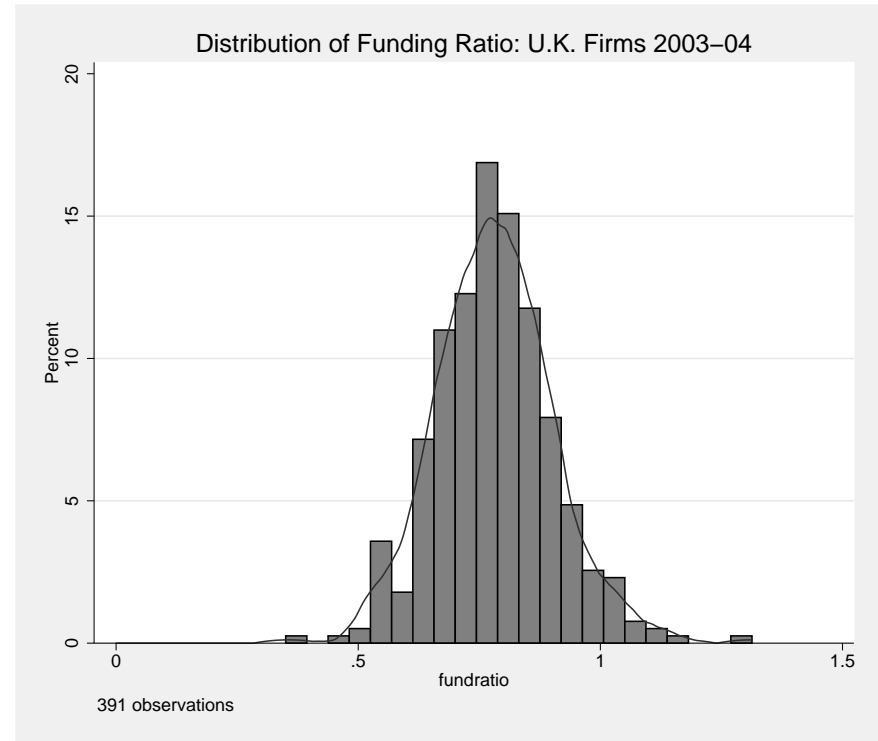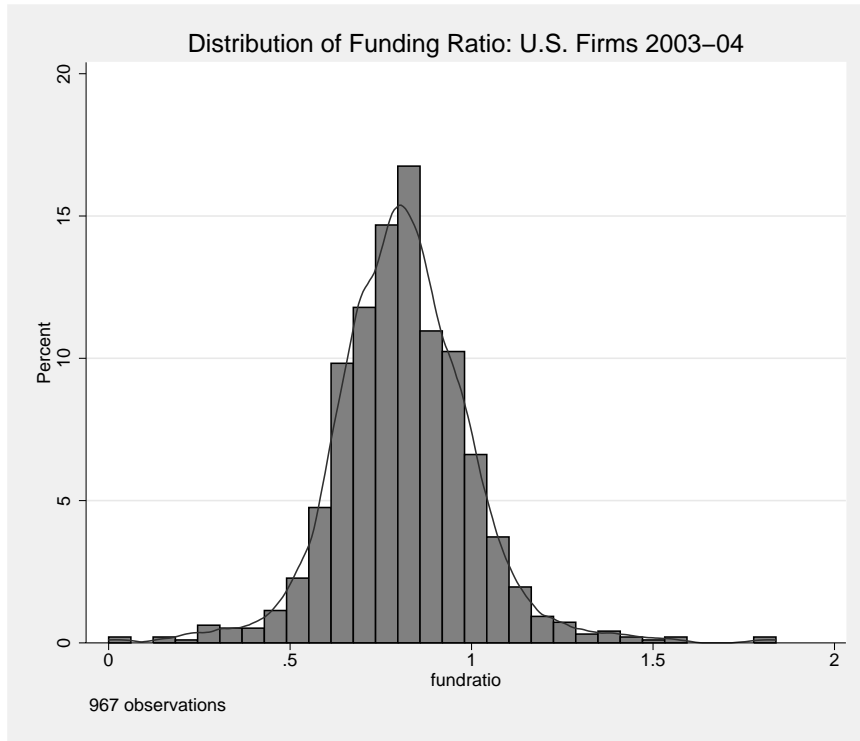
219 observations
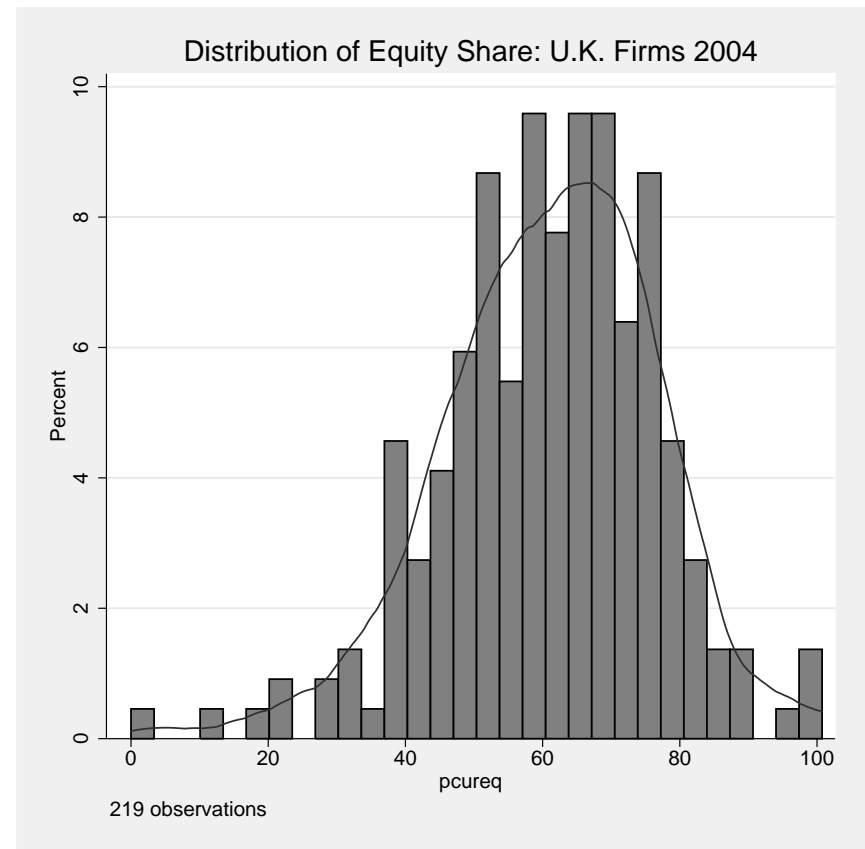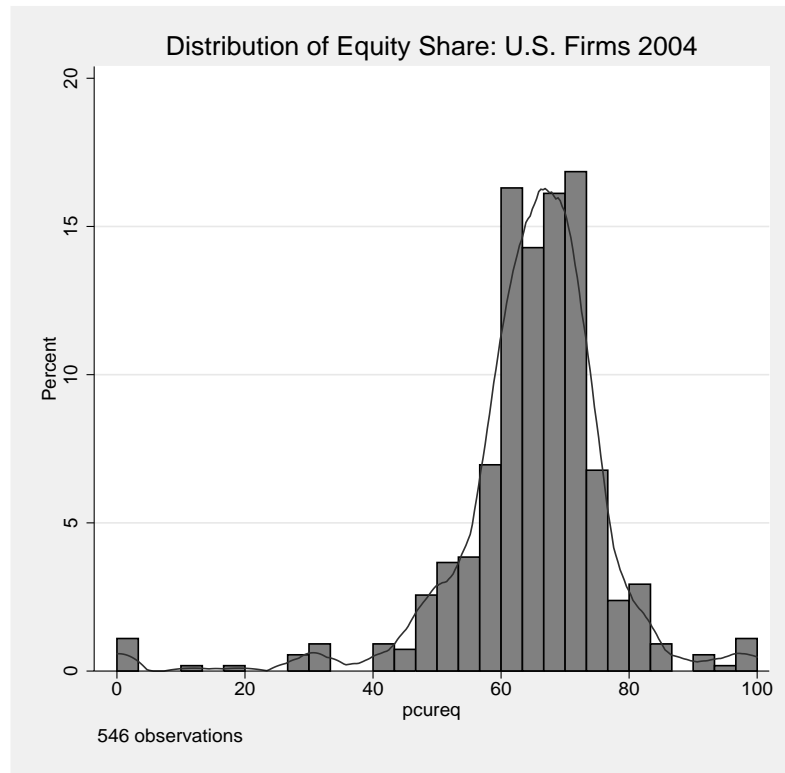
Risk Measures

- What are appropriate risk measures?
- Benefit security = financial security (ability to pay) + covenant (requirement to pay) + governance
- Types of guidelines:
  - Governance requirements
  - Funding rules
  - Risk-based premia for guarantee schemes
  - Priority creditor rights in case of sponsor bankruptcy
  - Risk controls
  - Vesting and portability of benefits
  - Indexation requirements

Which Measures Needed for Which Groups?

- High risk - intervention
- Medium risk – risk management/funding
- Lower risk - education

DC Pensions

Exposure to risk
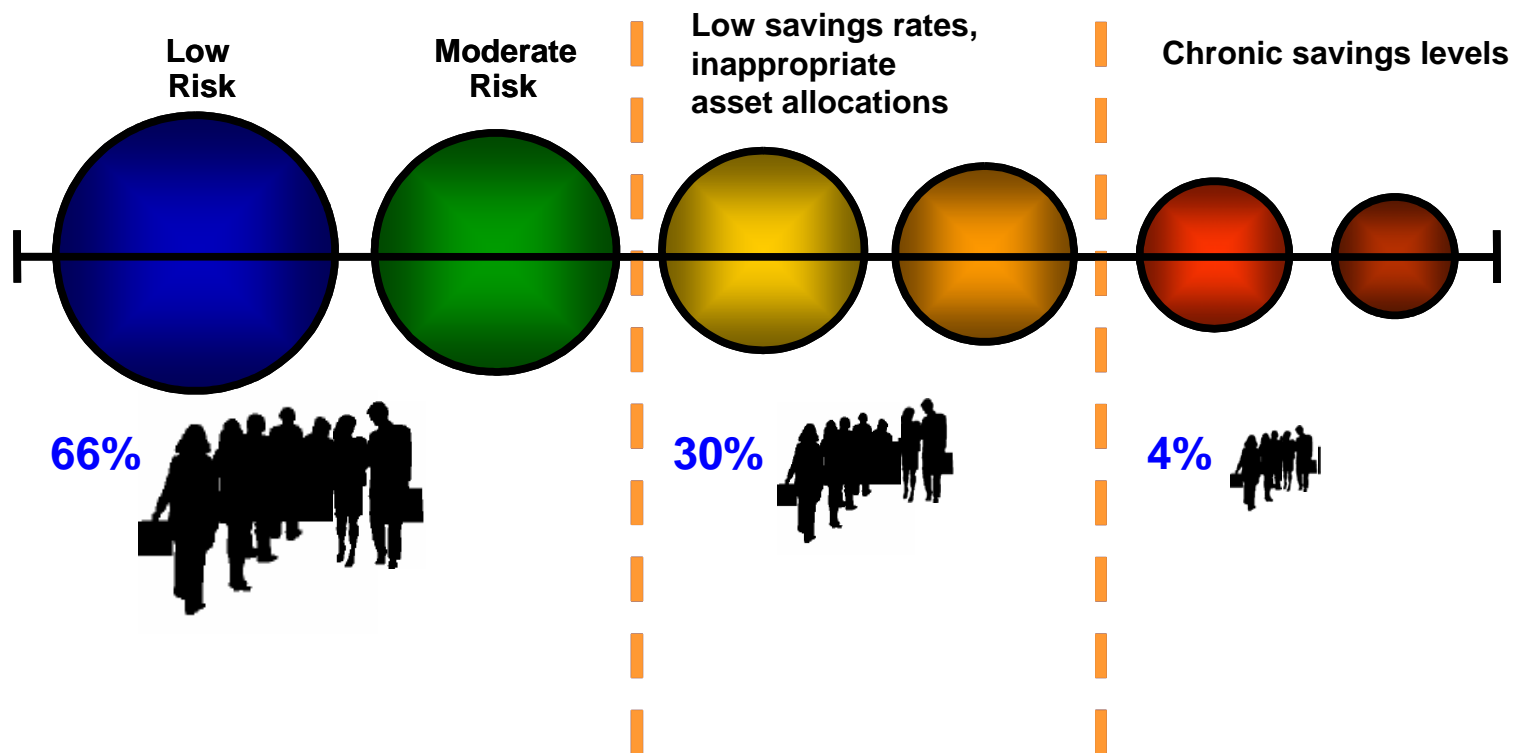
DC issues

- **Distribution:**
  - Member education
  - Intermediary regulation
  - Fees and cost control
- **Choice**
  - Investment
  - Contributions
- **Information**
  - Disclosure
  - Financial education

Which Measures Needed for Which Groups?

- High risk – strong defaults
- Medium risk – weak default options
- Lower risk – education and incentives

Summary

- Case for segmenting regulatory and supervisory attention into different groups
- Case for more targeted approach to regulation and supervision