

# Comments to: It's all Back to Front: Critical Issues in the Design of Defined Contribution Pension Plans By David Blake

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## DC Pension plan design From Back to Front

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### Six Elements

*Charges*  
*Lapses*  
*Investment strategy*  
*Investment performance*  
*Annuitisation*  
*Provider Incentives*

### Another 3 Elements

*Income profile*: Higher contribution might be required if a last salary RR is target and income profiles are steep  
*Regulation*: In many countries there is heavy regulation. The purpose?  
*Financial literacy*: How paternalistic should the plan be.

Each of these elements is involved in the final outcome of retirement income. Therefore, each element should be handled appropriately when the system is designed.

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### □ MAIN POINT OF THE PAPER:

“Pension plans should be seen as an integrated financial product, aimed at delivering adequate retirement income.”

### □ WHY IS THIS SO IMPORTANT?

Each element should be consistent with this goal:  
Those in the accumulation and those in the decumulation phase

DC Schemes tend to separate accumulation and decumulation phases,  
in some cases there are even different industries

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### □ Charges are too high and not related to performance

#### **Recommendations:**

- High charges could be capped
- Charging structure should be kept simple, transparent, non-front loaded
- Charging structure should contain performance-based considerations

#### **Comments:**

- Cap on charges has the usual problems of price caps, which should be the right level is not an easy question. There is a risk of a cap that would be too low or too high.
- Performance-based charging is subject to principal-agent problems (e.g., risk taking incentives, misalignment of incentives), which is specially problematic in mandatory system. The gain is uncertain according to what is mentioned in the paper and it might have negative side effects.
- Simplicity, transparency and portability are a must!

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- Investment strategy and annuitization

### **Recommendations:**

Investment strategy should be design around a focal pension level (preference -based, benchmark-based)  
Once the target pension has been determined, investment strategy should be aimed at replicating the corresponding payoff  
Annuity risk can be taken into account (numeraire change)

### **Comments**

- Very reasonable recommendation, but how to determine the pension target.
- Are investment strategies robust to minor changes in preferences or a loss criterion? How to deal with the heterogeneity among pension plan members? How to communicate information consistently? How much freedom to choose should be given to individuals?
- This is a very promising research avenue. A sensible risk-based limit for long-term investors require this answer as an input.

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