“Pension Fund Governance”

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Introduction

- Pension funds are organisations
- Pension funds must be managed
- For the welfare of beneficiaries
- Involving many other stakeholders

Simple organisations?

- Begin with a simple objective function
- Assume a coherent **means-ends** system
- With an unambiguous incentive structure
- Effectively ignore the issue of governance

Or complex organisations?

- The golden-rule is quite abstract
- Plan sponsors and stakeholders important
- Risk and uncertainty implies choice amongst options
- Discretion is an essential characteristic of pension fund governance

Governance matters!

- OECD definition suggests governance involves “a robust, process-oriented decision-making framework” including cost-efficient administrative, monitoring, and oversight functions.

Goals of governance

- Beneficiaries’ welfare
- A long-term metric
- Based either on paternalism
- Or individual autonomy and choice

Within constraints (static)

- Equitable treatment of beneficiaries
- Security of promised benefits
- Cost-efficient administration
- Plan-sponsor commitment

While retaining (dynamic)

- Capacity to respond to local needs
- And changing demand for pension benefits
- Reconciliation of stakeholders’ interests
- Thereby sustaining “local” efficiency/equity

Instruments of governance

- Model 1: Moral imperatives
- Model 2: Government regulation
- Model 3: Market discipline
- Individual **exit, voice, loyalty?**

Historical trajectory

- Based upon common law traditions
- Augmented by other rules and requirements
- Incorporated into legislative frameworks
- With, in some cases, market options

Model 1 – Moral imperatives

- Fiduciary duty a moral obligation
- Matched by notions like “father’s family responsibilities”
- Reliant upon community standards, self discipline and social approbation
- Compromised by inability to observe **intentions**

Model 2 – Legislative frameworks

- In response to public events – e.g. Maxwell
- Public standards re. equity and security
- Supplanting the employment relation
- Compromised by cost of rules and regulations

Model 3 – Market options

- Provide “discipline” re. costs and efficiency
- Different types of pensions; e.g.. DC schemes
- Dependent upon private contractual agreement and negotiation
- Compromised by market performance and the limits of contract

Imperfections and responses

- Unable to observe moral “intensions”
- Hence the role of market frameworks
- Unable to adapt to changing circumstances
- Hence the role of public frameworks
- Unable to observe market “interests”
- Hence the role of oversight (e.g. “ombudsmen”)

Regimes of governance

- No model can stand by itself
- Combinations represent national traditions
- As well as normative dispositions
- “Reform” an issue of model combination

R1: Moral commitment with back-up

- Dominant Anglo-American regime
- “Local” autonomy with public interest
- Public solution to equity and efficiency
- Those “outside” face the market

R2: Social market with innovation

- A version of social democratic traditions
- Social contract “governs” market institutions
- A social solution to equity and efficiency
- Those “outside” may be unprotected

R3: Efficiency within limits

- Premium placed on individual autonomy
- Private contract the regulatory mechanism
- Public oversight re. contractual fairness
- Efficiency (in theory) begets equity

Modes of compensation

- DB schemes – clearly Regime 1
- DC schemes – clearly Regime 3
- SS and DB (Europe) – clearly Regime 2
- Insurance – clearly regime 1 or 3

Conclusions I

- Governance regimes often ineffective
- Golden-rules ambiguous
- Legislative frameworks backward looking
- Both impose **costs** on participants re. the process of discipline

Conclusions II

- Governance regimes must enable action
- Allowing for “local” initiatives
- Encouraging responsiveness to changing circumstances
- Thereby reconciling in a dynamic fashion equity and efficiency

Conclusions III

- Current governance regimes are tangled
- Rely upon models that are poorly integrated
- Overlapping but antagonistic goals
- Even competing institutions

Conclusions IV

- Future **governance** regimes must be more dynamic, otherwise private pension systems will collapse to Model 3