

ASIA-PACIFIC REGULATORS' AND INDUSTRY DIALOGUE

Session 8 Future Steps

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SUMMARY PAPER

- The recent financial market turbulence stemming from the sub-prime crisis in the United States places a heightened focus on the health of financial sector entities, their capacity to absorb and adjust to market changes and the ability of regulators to monitor and respond appropriately to developments.
- There is also a heightened public focus and concern about the impact of these events on retirement savings, at least in countries with significant private pensions systems. One underlying driver of this heightened focus is the shift away from defined benefit schemes towards defined contribution schemes, involving a substantial shift of risk from the plan sponsor to the individual. The individual now has a more direct and immediate stake in the performance of their pension plan and the overall regulatory framework protecting their stake in that plan.
- These trends inevitably will have an impact on perceptions of Governments' duty of care to individual pension scheme members and the political economy risk Governments face in the event that something goes wrong. It is likely that these factors will also be reflected in the regulatory framework that is adopted and how that framework evolves over time.
- Within this context, national approaches will generally vary according to a number of factors: the underlying regulatory culture and expectations of the Government's role, the extent of ageing pressures, the historical development of the pension system, the maturity of national financial markets, the Government's fiscal position, to name but a few.
- At the same time, there is a growing consensus about some of the key attributes of modern, robust regulatory frameworks for private pension systems. These include prudential requirements with a particular focus on governance, a well resourced, empowered and independent regulator, reporting and disclosure to both regulators and consumers.
- The relative emphasis placed on these attributes and the way in which they manifest in practice may be conceived of in terms of a continuum, with a highly discretionary, principles-based, 'prudent person' approach to private pensions regulation (characterised by a primary reliance on fit and proper, solvency, resource adequacy, risk management) located at one end, and a directive, formulaic model (characterised by quantitative investment controls aimed at defining what are safe and prudent investments) located at the other.
- Most private pension systems are located somewhere along this continuum. The relative bias remains towards a directive model, although this is changing over time.
- As pension systems develop and mature, there are signs that regulators are moving along this continuum, removing or relaxing quantitative investment limits (for example, in recent years Korea has removed restrictions on domestic listed equities and allowed investments in

unlisted equities) and introducing strengthened governance as well as enhanced risk management approaches.

- As this process continues, instilling a strong and professional ‘governance culture’ and acceptance of the importance of self-regulation among pension fund administrators will become more important.
- Although cross-national comparisons are often problematic and do not adequately take into account the national context, the available evidence suggests that these trends are to be welcomed. A growing number of surveys point to some significant benefits stemming from prudent person approaches to pension fund regulation, with these systems performing better over the medium- to long-term than systems favouring directive approaches.
- These developments are positive, but they do not come easily. There may be a reluctance to relax quantitative rules where there are concerns about the capacity of the industry to respond effectively. Market turmoil such as that experienced recently and in the 1997 Asian financial crisis may heighten concerns about the level of exposure of pension fund members to risk, particularly where members are not well informed and a strong governance culture is still emerging. Reforms need to be staged, and reform pathways need to be identified which can facilitate this process.
- This process can be facilitated in part by policy makers actively (and candidly) sharing their experiences with pensions and broader financial system reform. There need to be mechanisms to facilitate cross-national exchange of experiences, including in, but not limited to, a number of key areas:
 - Development of local financial market infrastructure and regulatory frameworks and oversight by independent and well-resourced regulators;
 - Achieving an appropriate balance between ‘prudent person’ and directive approaches to pensions regulation and providing reform pathways over time;
 - The promotion of good governance practices, centred on the role and responsibilities of pension fund administrators as fiduciaries with a duty of care to their fund members; and
 - Facilitating informed engagement by pension fund members in the handling of their retirement income savings through disclosure and financial education.
- Australia is playing a role in enabling such a process through its co-sponsorship with the Peoples Republic of China, Indonesia and the Asian Development Bank of the establishment of a web-based ‘Catalogue of Policy Experiences and Choices’. This initiative was endorsed by the APEC Finance Ministers’ Meeting in August 2007, with the objective of collating information about APEC economy experiences with financial sector reform and facilitating information sharing between finance ministries, central banks and financial sector regulatory agencies. The pilot website is being developed for launch in April 2008.