

The Effect of the Financial Crisis on U.S. Pensions – A Perspective on Financial Services Regulatory Reform

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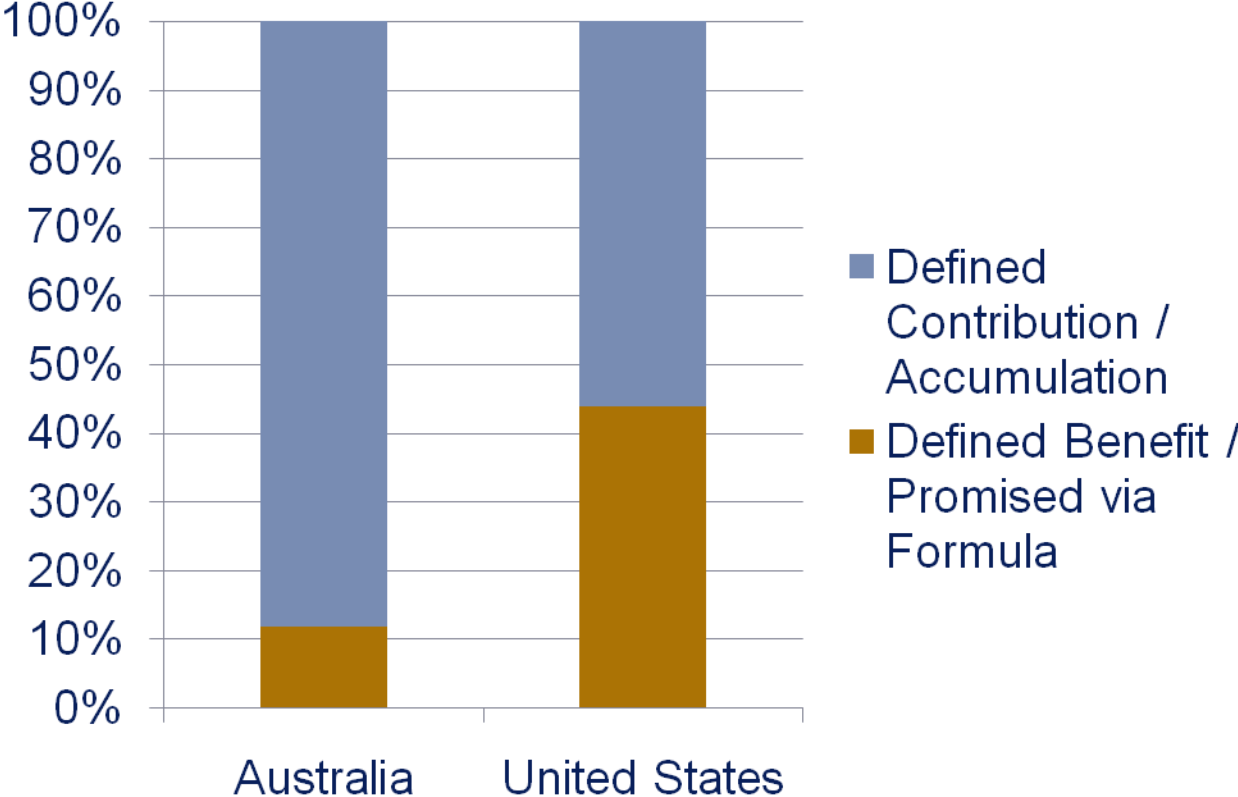
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Overview

- Overview of retirement/superannuation savings accounts in the U.S. and Australia
- Effect of financial crisis on account assets
- Australian implications for reform of U.S. financial services regulation
- Potential effect of financial services regulatory reform on U.S. pension regulation

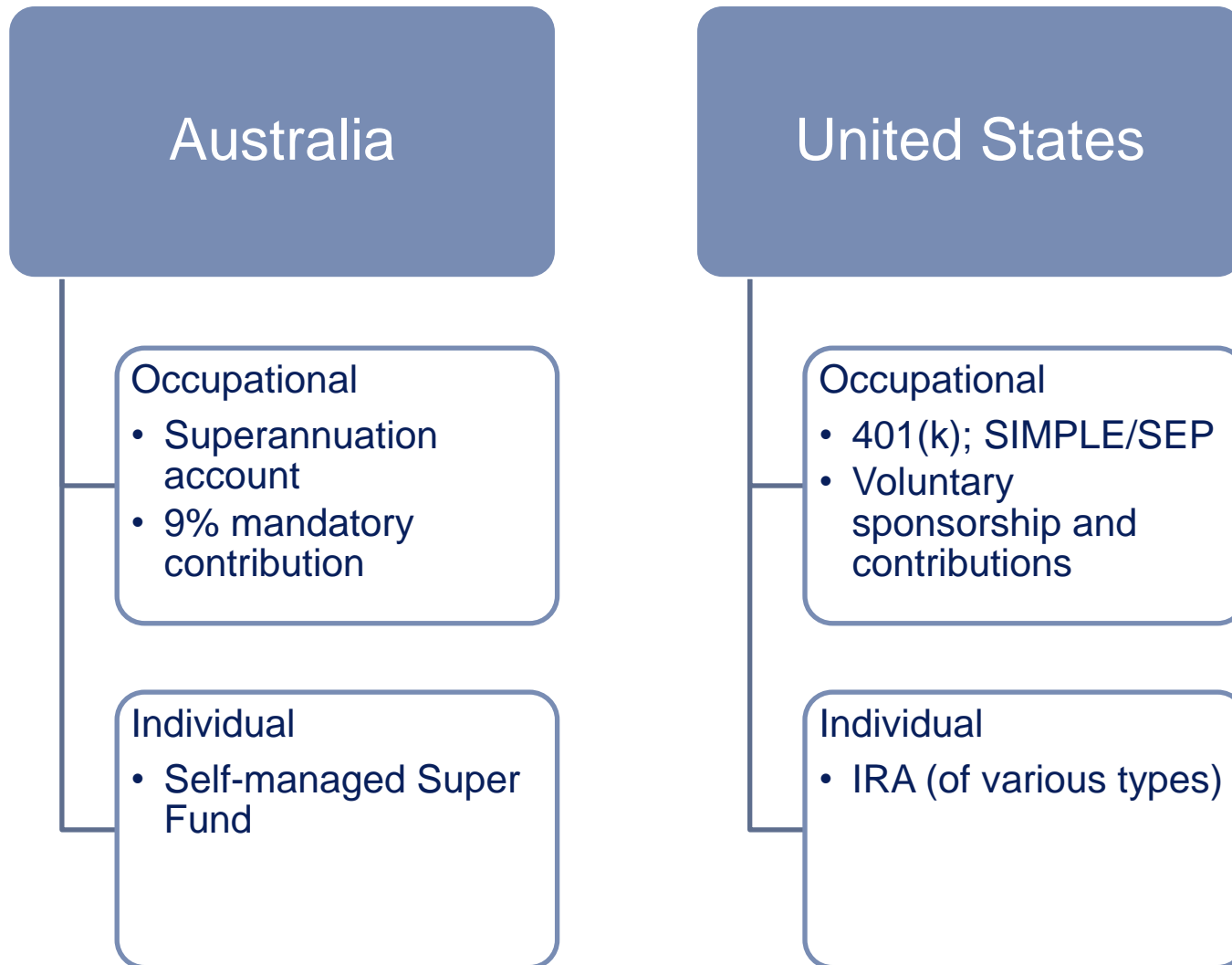
Types of Pension Accounts

Percentage of assets



Source: Watson Wyatt 2009 Global Pension Assets Study

Types of Accumulation Pension Accounts



Accumulation Pension Accounts and Financial Crisis

- The Global Financial Crisis (GFC) of 2008 is the first extended, significant financial downturn since accumulation accounts became the primary type of occupational pensions.
 - U.S.: 1995 was the equalization point in DB/accumulation assets
 - Australia: 1986 superannuation productivity award and 1992 institution of superannuation guarantee
- Economic evaluations
 - Overall losses in accumulation accounts
 - Age cohorts
 - Income cohorts
 - Account size cohorts
 - Effects on voluntary contribution behaviors

Effect of Financial Crisis on Pension Assets

	Percentage Decrease in S&P Index (500/ASX 200) 2008	Pension Assets 31 Dec. 2008 (in billions; U.S. \$)	Percentage Decrease in Assets (local \$) 2008	Percentage Decrease in Assets (U.S. \$) 2008	Percentage GNP 31 Dec. 2008
U.S.	37	\$12,439	18.9	18.9	87
Australia	38.45	\$718	16.2	33.9	67

All data from Watson Wyatt Worldwide, 2009 Global pension Assets Study (Jan. 2009)

Risk Factors in Accumulation Plans – Definitions (U.S.)

Risk to employees	Accumulation	DB
Investment Risk	Risk of gains/losses on investments	No direct risk to employees; direct risk absorbed by employer; indirect risk limited in the U.S. by PBGC guarantee
Participation and Contribution Risk	Participation – Risk of not having access to a plan Contribution – Risk of not having contributions made to a plan	Participation – same Contribution – if an occupational DB plan existed, then ‘fair’ contributions were made
Longevity Risk	Risk of outliving accumulated assets	No direct risk because benefits typically paid as an annuity.

Risk Factors – Comparative Analysis

Risk	United States	Australia
Investment Risk	High -employee choice ; many options; undiversified opportunities; limited use of defaults	Lower -- limited options and no/fewer undiversified opportunities; increased use of defaults
Participation and Contribution Risk	High -voluntary plan sponsorship -voluntary plan contributions (also 'leakage')	Much Lower --mandatory super contributions
Longevity Risk	High -lump sum distributions	Same

Perceived Regulatory Problems – U.S. Financial Services

- Lack of regulation across investment products/types of financial services firms, resulting in regulatory gaps (no one regulating credit default swaps; lack of prudential oversight)
- Too many regulators shared authority over some products/types of financial services firms, resulting in lack of regulatory depth and inconsistencies (Bernie Madoff ponzi scheme)

Perceived Regulatory Problems – U.S. Financial Services – Says Who?

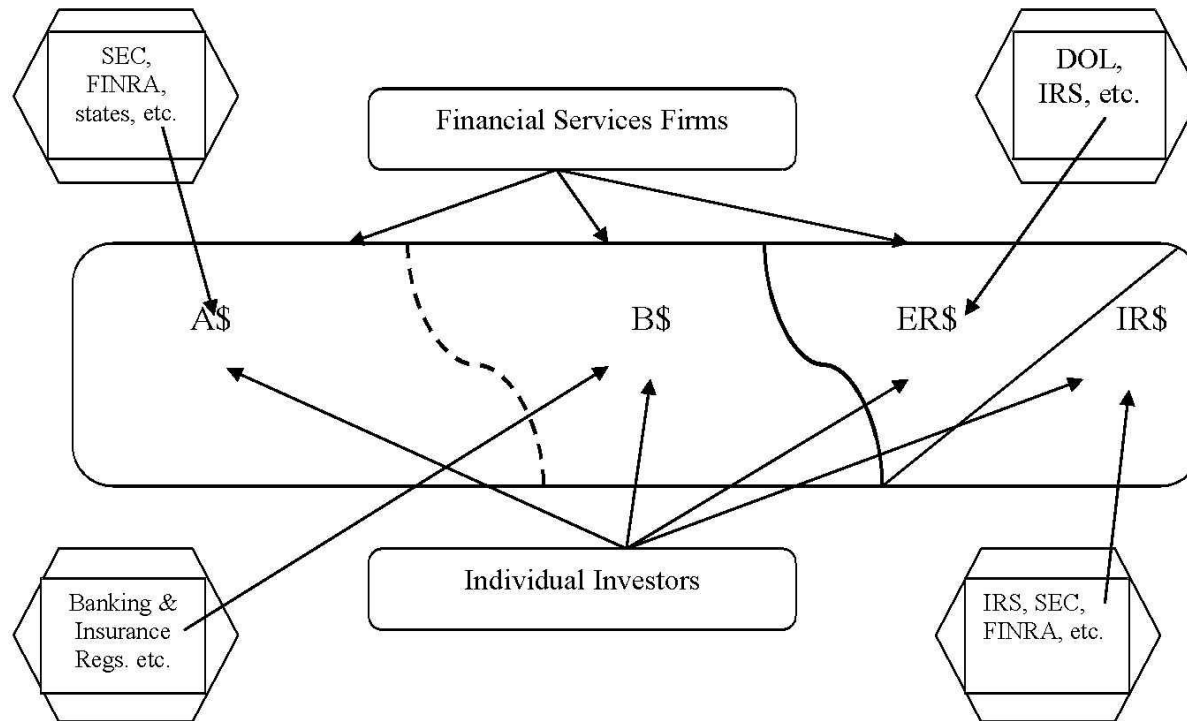
- Bush Administration
 - Secretary of Treasury Paulson - *The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure (Blueprint)*, March 2008
 - Solution: Reorganize regulators/regulation using the Australian model including a new business conduct regulator.
- Obama Administration
 - Treasury Dept. – *Framework for Regulatory Reform (Framework)*, March 2009
 - Solution:
 - Eliminate regulatory gaps and increase consumer protection (March 2009)
 - Discussions of regulatory commission to protect consumers re: all financial products (19 May 2009)
- Professor Elizabeth Warren

Reform - Consolidation

- "One of the real tragedies and one of the real lessons of this tragedy is that we have this stovepiped approach to regulation that allows misconduct to take place out of the sight of at least some of the regulators.... “
 - New SEC Chair, Mary Schapiro, at her confirmation hearing. Sara Scannell, *Crisis on Wall Street: Schapiro Pledges Vigilance as SEC Chief*, Wall St. J., Jan. 16, 2009, at C3

Fragmentation of U.S. Regulatory Authority - Investments

Figure 1



A\$ retail securities

B\$ bank savings

ER\$ empl. ret.

IR\$ indiv. ret.

SEC Sec. & Exch. Comm.

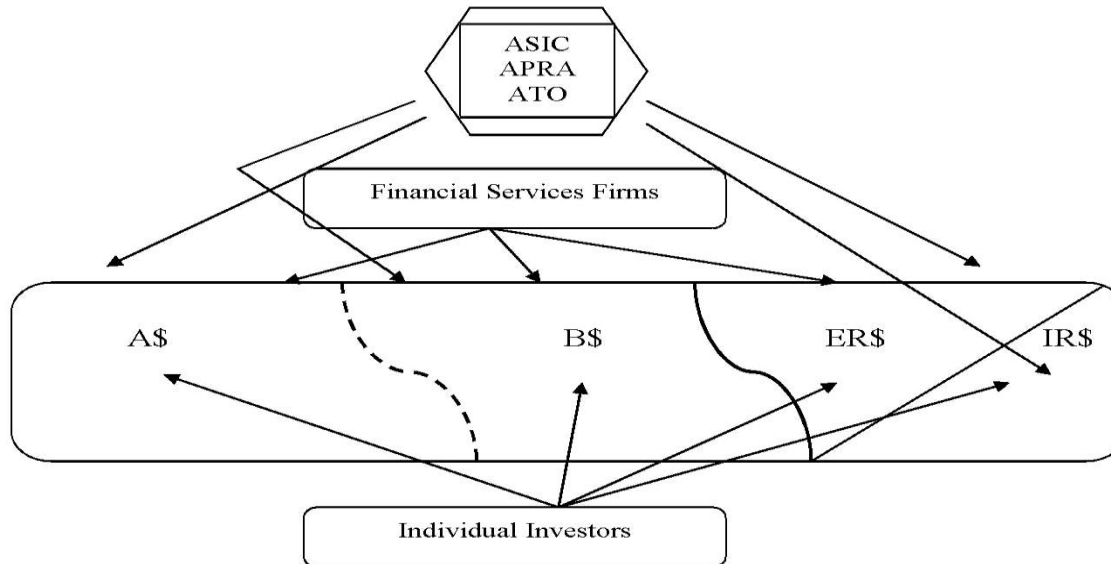
FINRA: indus. self-regul.

DOL: Dept. of Labor

IRS: Intl. Rev. Svc. (tax)

Fragmentation of Australian Regulatory Authority - Investments

Figure 1



A\$ retail securities
B\$ bank savings
ER\$ empl. ret.
IR\$ indiv. ret.
ASIC
APRA
ATO

Efficiencies to be Gained - Examples

Issue	U.S.	Australia
Product Disclosure/Marketing	Differences between accounts	ASIC: what detail?
Ongoing Prod. Disc.	Ex. Employer stock Inv. Acct: sec. disclosure Ret Acct: fiduciary	ASIC: what detail?
Fees	Differences between accounts	ASIC: What detail of disclosure?
Improper Acct Admin	Differences between accounts	FOS/Tribunal
Investment Advice	Differences between accounts	?? Specialized for 'simple advice' in super accounts

Effect of Regulatory Consolidation on US Accum. Accounts

Risk	US - Current	US - w/ consolidation
Investment Risk	High -employee choice ; many options; undiversified opportunities; limited use of defaults	Still High -- some positive effect from 'better' disclosure
Participation and Contribution Risk	High -voluntary plan sponsorship -voluntary plan contributions (also 'leakage')	Still High --some positive effect on plan contributions from 'better' disclosure
Longevity Risk	High -lump sum distributions	Same

Conclusions

- Financial crisis has had substantial impact on accumulation accounts
- U.S. reform of financial markets and services regulation is likely to affect the regulation of accumulation accounts
- That regulatory reform, through consolidation of regulatory responsibility across financial services products, is likely to improve regulation of accumulation accounts and bring regulation closer to the Australian model
- That regulatory reform, however, would not address the underlying risk factors that prevent accumulation accounts from providing minimally sufficient retirement funds to working Americans

Thank You

- Questions or comments?

Back-up

Development of Regulation (background summary)

- U.S.
 - Employee Retirement Income Security Act of 1974 (ERISA)
 - DB plans were largest in number, in number of participants, and in asset value; voluntary employer plan sponsorship and contributions
 - Issues were: plan funding, misuse and misappropriation of plan assets, and lack of vesting
 - Regulators: Department of Labor, Internal Rev. Service
 - Subsequent amendments but no change in structure
- Australia
 - 1987 Occupational Superannuation Supervision Act – established Insurance & Superannuation Commission
 - 1992 Superannuation Guarantee began July; 1993 Superannuation Industry (Supervision) Act 1993 (SIS Act); 1996 Wallis Report; 1998 APRA and ASIC
 - 2001 Financial Services Reform Act – consistency across financial product disclosure and consumer protection

Obama Administration Reform Framework

- Addressing Systemic Risk (first priority)
- **Protecting Consumers and Investors**
 - “strengthen enforcement and improve transparency for all investors”
- **Eliminating Gaps in U.S. Regulatory Structure**
 - “Our regulatory structure must assign clear authority, resources, and accountability for each of its key functions”
- International Coordination

From Treasury Outlines Framework for Regulatory Reform, 26 March 2009.

Comparison of Regulatory Issues

Issue	U.S.	Australia
Product Disclosure/Marketing	Inv/Ret Accounts – difference in adv info	ASIC: what detail?
Ongoing Prod. Disc.	Ex. Employer stock Inv. Acct: sec. disclosure Ret Acct: fiduciary	ASIC: what detail?
Fees	Inv/Ret Accounts – diff standards for approp level (IA in SCt)	ASIC: What detail of disclosure?
Improper Acct Admin	Inv Acct: FINRA arb. Ret Acct: federal court, no damages	FOS/Tribunal
Investment Advice	Inv Acct: Inv Adv Act Ret Acct: fiduciary	ASIC – common law negl.; suitability