Institutional Investors

From Myth to Reality

Some Comments, Suggestions for Future Research

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Research on Institutional Investors

- **Excellent, relevant, timely. Thank you!**
- **More research is needed. Why? Several reasons:**

1. Bank promoted multi-pillar reforms in 1990s, 2000s, second pillars a la Chile
   - About 25 emerging countries adopted. New systems not working well in most countries
   - Six serious casualties (Argentina, Hungary, Russia, Poland, Slovakia, Czech)
   - Many other countries downsizing their new mandatory systems.
   - What to do? New approach emerging: Try to salvage existing ones; new emphasis on voluntary, employer-based systems for new client requests
2. New post-2015 finance for development agenda endorsed by the Board
   - Emphasis on Long Term Finance, need for solid investor base. What to do?
3. Concerns with destabilizing role of Institutional investors in post crisis world
   - Especially investment funds, but some concerns with PFs, ICOs as well

Some Suggestions for Future Research

- On the Lack of Institutional Investors
  - Several countries have developed instruments faster than institutional investors
  - Excessive reliance on banks, retail investors. Is there anything worse than that?

- On Investment Funds
  - Results are extremely interesting, especially the problem of endogenous weights
  - Central issue in FSB discussions currently. But what are the policy implications?
  - Can investment funds become a reliable component of the investor base in EMDEs?

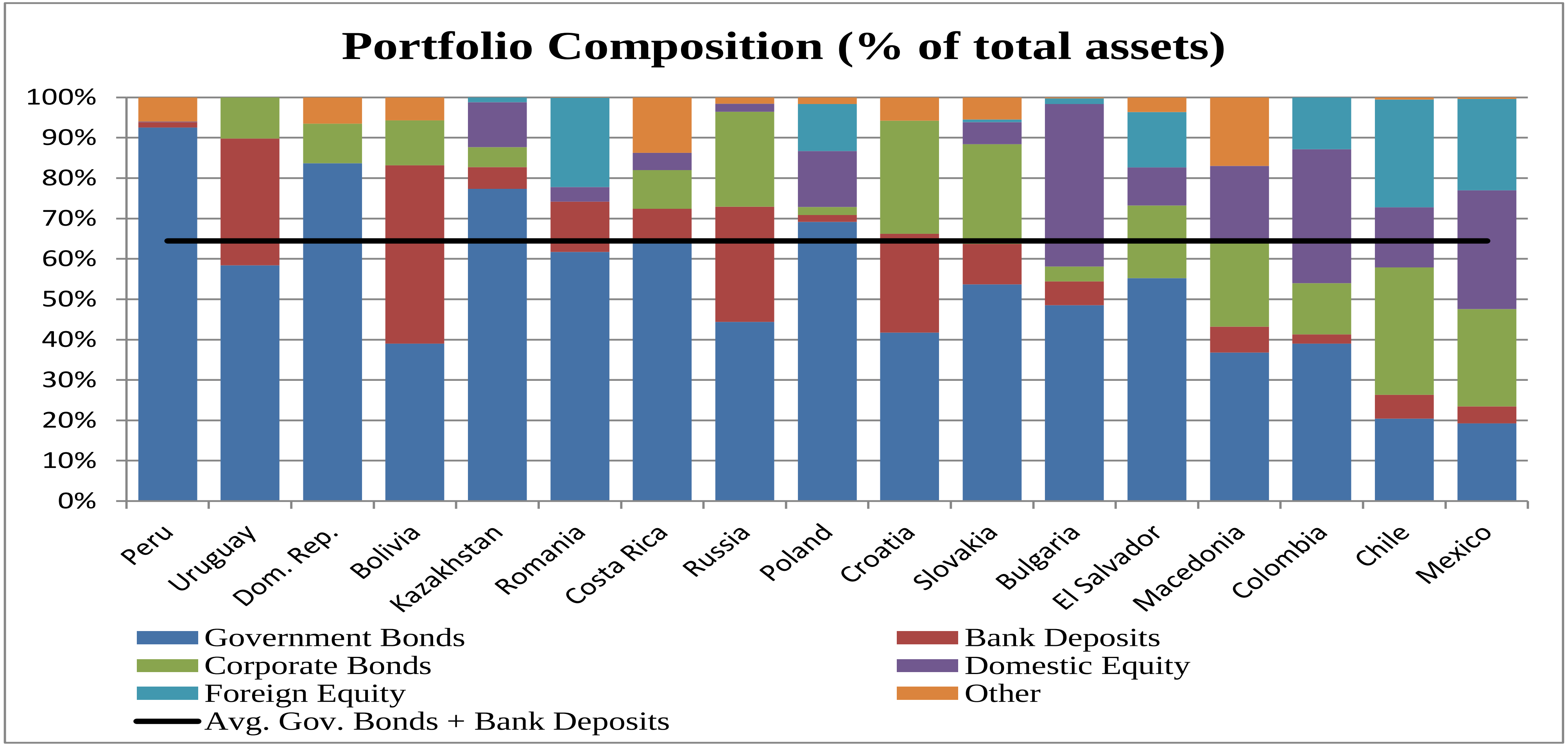
- On Insurance Companies
  - Need to be careful in comparisons with Chile. Share of annuity providers in Chilean life sector higher than any other country in the world.
  - In other countries, asset composition is very related to structure of liabilities, which can be very different (unit-linked, with-profits, non-profit and non-linked)
  - Suggestion: More research with more granularity. In particular, examine the impact of the bancassurance model in expanding coverage. Examine life products, regulation and outcomes. This may become a major channel for pension coverage in the future.

Some Suggestions for Future Research

- On Pension Funds
  - Twenty five emerging countries copied Chile, but other countries did not, especially higher income OECD countries, but also several MICs
  - More research needed, exploring differences in performance of employer-based systems versus open, individual, retail systems. Types of employer-based:
    - Occupational funds (with boards), both DB and DC
    - Contract-based funds (no boards), such as 401(k) plans
  - Employer-based pension funds are also being criticized in other countries for:
    - Herding
    - Failing to explore their long-term investment horizon, especially DC funds
    - Even for being pro-cyclical, although evidence here is very very mixed
  - However, when we compare the performance of employer-based funds with those of open, individual, retail, based funds they still look much better
    - Several countries have all these types, allowing for insightful comparisons
    - Need to understand better the reasons for differences in performance

Chilean-based systems: Portfolios remain disappointing in many cases

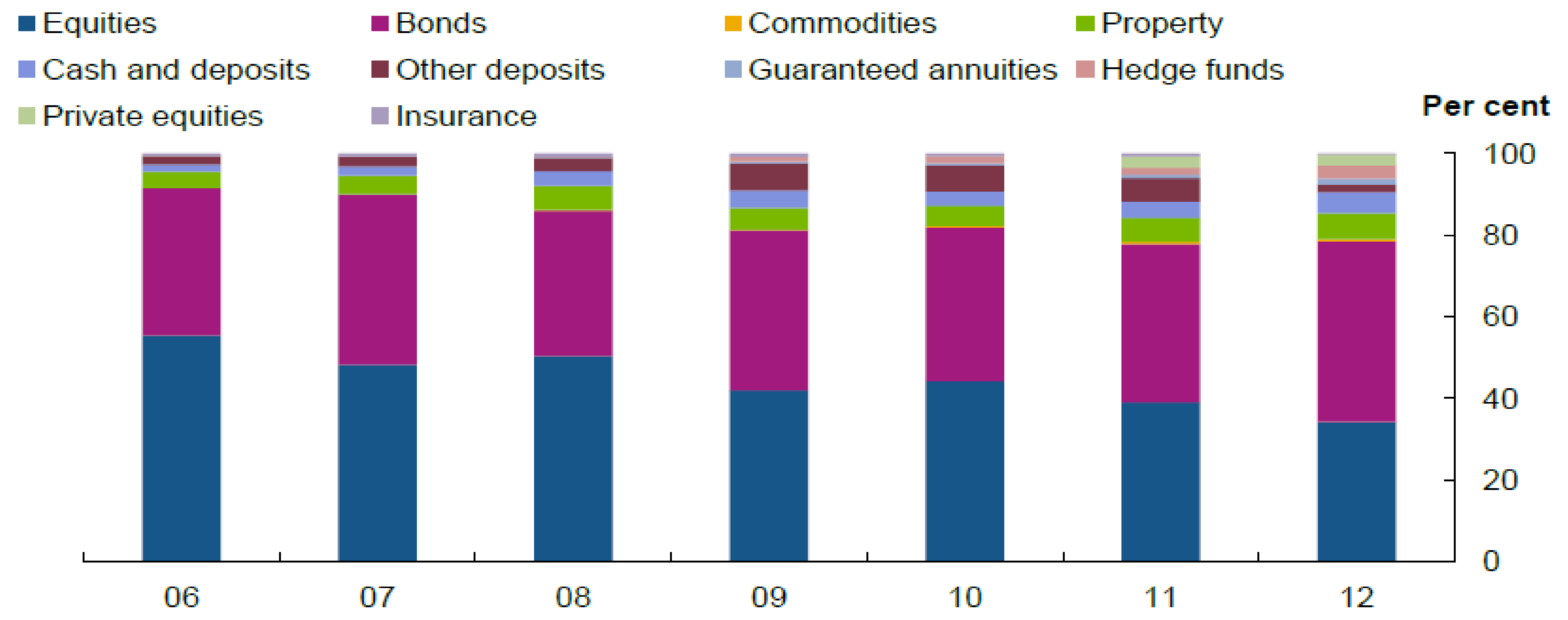
Share of government bonds (with short durations) and bank deposits is 70% of assets or higher in many countries



Source: World Bank from National Sources, OECD global pensions database

UK Corporate DB Funds:
De-risking from a very high initial share of equities in portfolios
But how bad does it look?

Chart 14: Aggregate asset allocations of UK corporate defined benefit pension schemes[(a)]



Source: Pension Protection Fund and Bank calculations
(a) All 5240 schemes from the PPF dataset are included.

Asset mix differences have been the primary reason for the under performance of U.S. DC plans (Mike Heale 2015)

Sure, but their performance does not look so bad by comparison with most countries that copied Chile

DB versus DC asset mix - U.S.

Asset class (Ranked by returns)	Asset mix [3]		Returns [4]	
	DB	DC	DB	DC
Private Equity	4%	n/a	12.6%	n/a
Real Assets	5%	n/a	9.3%	n/a
Small Cap Stock	6%	7%	10.2%	8.4%
Employer Stock	0%	21%	n/a	8.6%
Fixed Income	31%	10%	6.8%	6.7%
Hedge Funds	2%	n/a	7.7%	n/a
Stock U.S. Large Cap or Broad	26%	30%	6.8%	6.1%
Stock Non U.S. or Global	23%	7%	6.7%	6.5%
Stable Value/GICs	n/a	17%	n/a	4.9%
Cash	2%	8%	2.9%	3.2%
Total	100%	100%	7.9%	6.9%
Number of observations	3,083	1,995		

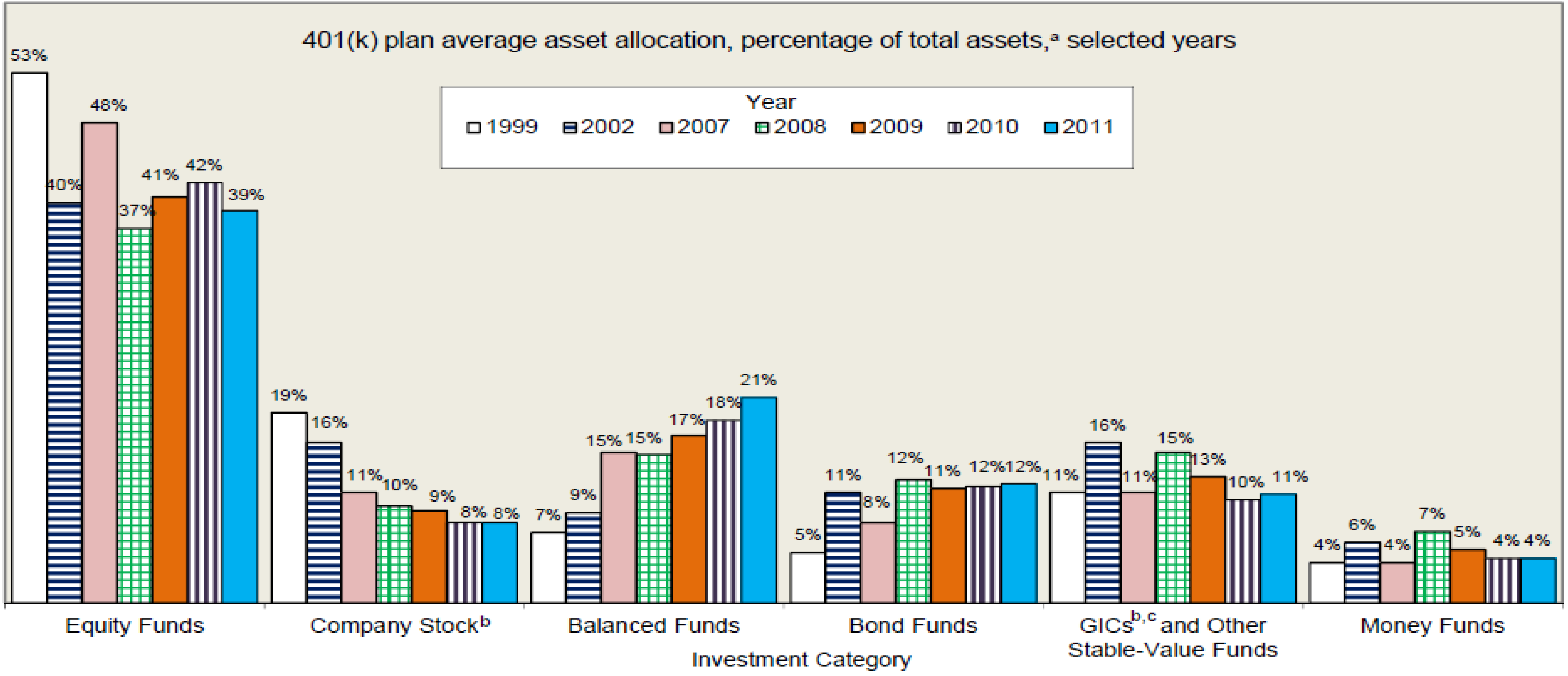
3. 17 years ending 2013. Equals arithmetic average of annual asset mix weights.
4. 17 years from 1997 to 2013. Returns are the geometric average of the annual averages for each asset class. Hedge funds were not treated as a separate asset class until 2000, so 60% stock, 40% bond returns were used as a proxy for 1997-1999.

n/a= insufficient data.

How about 401(k) plans? Again, not so bad by comparison

Figure 20

401(k) Plan Assets Are Concentrated in Equities



Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.
[a] Minor investment options are not shown; therefore, percentages do not add to 100 percent. Percentages are dollar-weighted averages.
[b] Not all participants are offered this investment option. See Figure 22.
[c] GICs are guaranteed investment contracts.
Note: "Funds" include mutual funds, bank collective trusts, life insurance separate accounts, and any pooled investment product primarily invested in the security indicated.

401(k) plans: increasing adoption of target dates

Figure 21

Average Asset Allocation of 401(k) Accounts, by Participant Age

Percentage of account balances,[a] 2011

Age Group	Equity Funds	Target-date Funds[b]	Non-Target-date Balanced Funds	Bond Funds	Money Funds	GICs[c,d]/Stable-Value Funds	Company Stock[d]	Other	Unknown	Total[a]
20s	32.8%	31.3%	11.2%	7.4%	2.3%	3.9%	6.4%	1.9%	2.8%	100%
30s	43.8%	19.4%	7.9%	9.0%	3.0%	4.9%	7.0%	2.5%	2.6%	100%
40s	45.5%	13.8%	7.0%	10.0%	3.5%	6.8%	8.2%	3.0%	2.2%	100%
50s	37.9%	11.9%	7.1%	12.5%	4.5%	11.6%	9.1%	3.4%	2.0%	100%
60s	31.8%	11.0%	6.8%	15.0%	6.1%	17.0%	7.3%	3.1%	2.0%	100%
All	39.2%	13.3%	7.2%	11.9%	4.4%	10.8%	8.2%	3.1%	1.9%	100%

Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

[a]Row percentages may not add to 100 percent because of rounding. Percentages are dollar-weighted averages.

[b]A target-date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

[c]GICs are guaranteed investment contracts.

[d] Not all participants are offered this investment option. See Figure 22.

Note: "Funds" include mutual funds, bank collective trusts, life insurance separate accounts, and any pooled investment product primarily invested in the security indicated.

Australian case: Excellent candidate for further research

Corporate and Industry Funds (Multi-employer) performing better than individual-retail funds

Table 13 Rate of return (ROR) and volatility

Entities with more than four members

	Jun 2004	Jun 2005	Jun 2006	Jun 2007	Jun 2008	Jun 2009	Jun 2010	Jun 2011	Jun 2012	Jun 2013	2004 - 2013	
											Average ROR	Volatility
All entities	12.2%	12.2%	13.3%	14.5%	-8.1%	-11.5%	8.9%	7.8%	0.6%	13.7%	6.0%	9.5%
Corporate	12.2%	12.8%	14.0%	15.3%	-9.3%	-8.2%	9.4%	8.0%	1.7%	12.3%	6.5%	9.0%
Industry	13.4%	13.2%	13.1%	16.0%	-6.0%	-11.7%	8.5%	9.0%	0.9%	14.4%	6.7%	9.5%
Public sector	13.9%	14.1%	14.9%	15.1%	-5.8%	-12.3%	9.8%	8.9%	1.7%	14.2%	7.0%	9.7%
Retail	10.8%	10.6%	12.4%	13.4%	-10.2%	-11.5%	8.7%	6.5%	-0.5%	13.1%	4.9%	9.4%

Why? Fewer choices, greater use of defaults

Investment choice

Table 17 Investment choice by fund type

Year end June 2013

Entities with more than four members

	Corporate	Industry	Public sector	Retail [a]	Total
Number of entities with more than four members	108	52	38	127	325
Number of entities offering investment choice	47	49	28	96	220
Proportion of entities offering investment choice	43.5%	94.2%	73.7%	75.6%	67.7%
Average number of investment choices offered per entity [b]	7	11	9	265	121
Total assets ($m)	61,300	324,668	256,864	422,777	1,065,607
Assets of entities offering investment choice ($m)	58,073	323,790	254,572	412,170	1,048,605
Assets in entities offering investment choice	94.7%	99.7%	99.1%	97.5%	98.4%
Assets in default investment strategy [c] ($m)	28,758	218,125	137,573	81,672	466,129
Proportion of assets in the default strategy	46.9%	67.2%	53.6%	19.3%	43.7%

[a] Excluding ADFs and ERFs, 88 per cent of retail superannuation funds offer investment choice.

[b] The average number of investment choices offered per entity refers to those entities that offer investment choice.

[c] Funds may have more than one default investment strategy, in which instance the largest default strategy is generally reported. Where there is no default strategy, funds may report the strategy of the largest option or the strategy of the whole fund.

And the defaults seems to be doing a better job

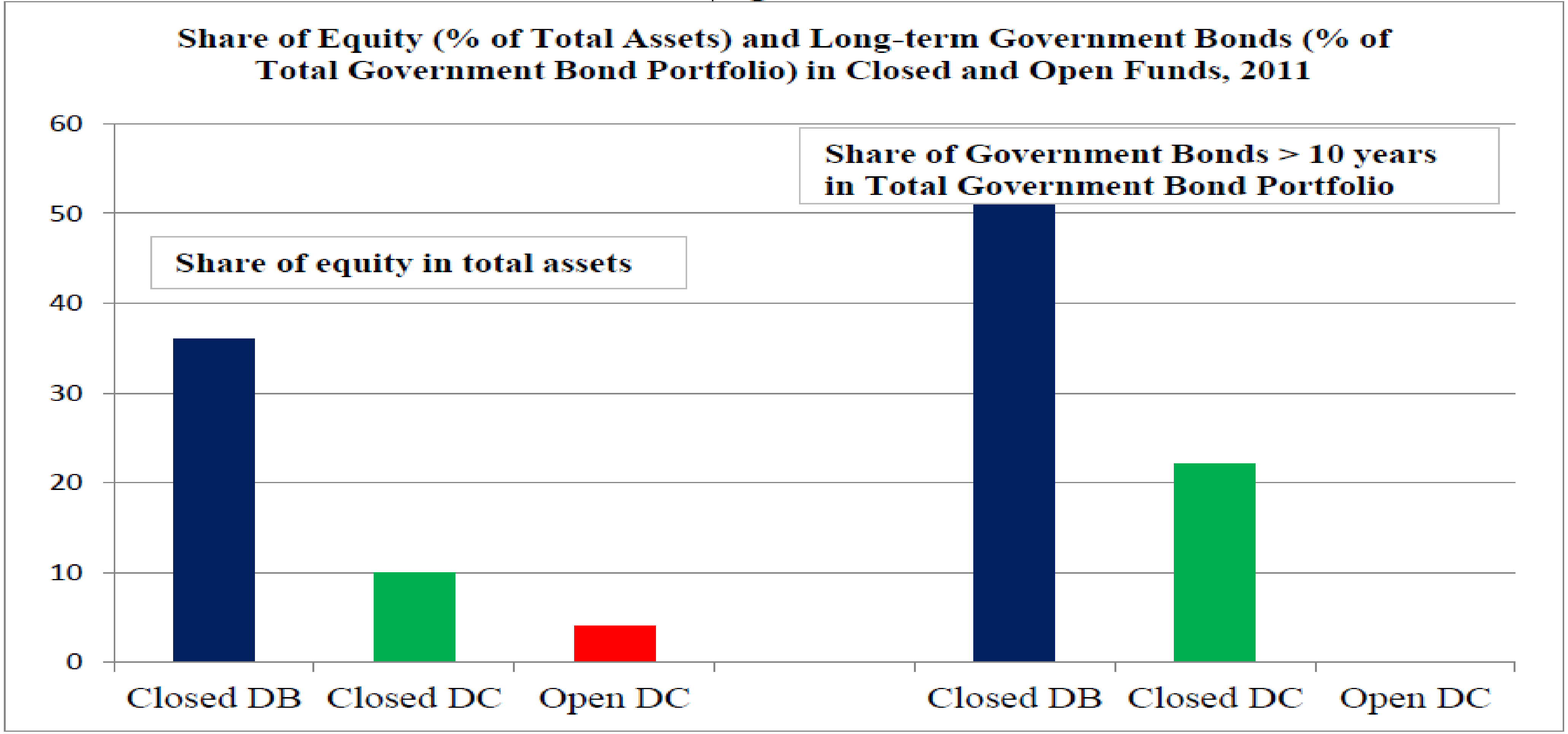
	Corporate	Industry	Public sector	Retail	Total
Proportion of assets					
Australian shares	30%	29%	22%	26%	26%
International shares	28%	25%	27%	22%	25%
Listed property	1%	1%	4%	4%	2%
Unlisted property	7%	10%	6%	2%	7%
Australian fixed interest	14%	6%	7%	15%	9%
International fixed interest	6%	5%	7%	7%	6%
Cash	6%	6%	9%	14%	8%
Other assets	8%	19%	18%	9%	16%
Total	100%	100%	100%	100%	100%

[a] Funds may have more than one default investment strategy, in which instance the largest default strategy is generally reported. Where there is no default strategy, funds may report the strategy of the largest option or the strategy of the whole fund.

Brazil: Another good candidate for research

The very poor performance of open, individual, retail plans

Figure 2



Source: Susep, Previc