

Panel 3: Use of Default Vehicles: Different Countries, Different Takes

Stephen P. Utkus, Moderator
Vanguard Center for Retirement Research

Jaime de la Barra
Compass Group

Nick Callil
Towers Watson

Richard Gröttheim
AP7



Chilean Pension System

June 2014

▶ Chilean Pension Fund System

- > Inception: 1981
- > Three Pillars: Minimum Government Guarantee, Mandatory DC, Voluntary (Tax incentives) Defined Contribution Individual Accounts
- > Managed by private sector single purpose Pension Fund Management Companies (AFPs) that act as fiduciary third party manager
- > AFPs manage mandatory and voluntary accounts
- > Individual “worker” choice:
 - Between AFP and type of “Asset allocation fund”
 - Freedom to change manager and fund
 - Flexible pension redemption schemes
- > Universal rules
- > Asset allocation funds serve as “savings” vehicles and building blocks for glide paths.
- > Funds differ among each other based on the range of equity and fixed income allocation allowed by law. (asset class based guidelines)

▶ Chilean Pension Fund System

Number of AFPs	6
Asset Allocation Funds Offered	5
Total Industry AUM	USD 162bn 59% of GDP
Worker Contribution	10% of gross salary
Employer Contribution	0
AFP Fees	1.45% of salary 1.26% disability Insurance
Number of Accounts	9.5 million
Number of Contributing Accounts	4.9 million
Average Real Return since inception	8.9%

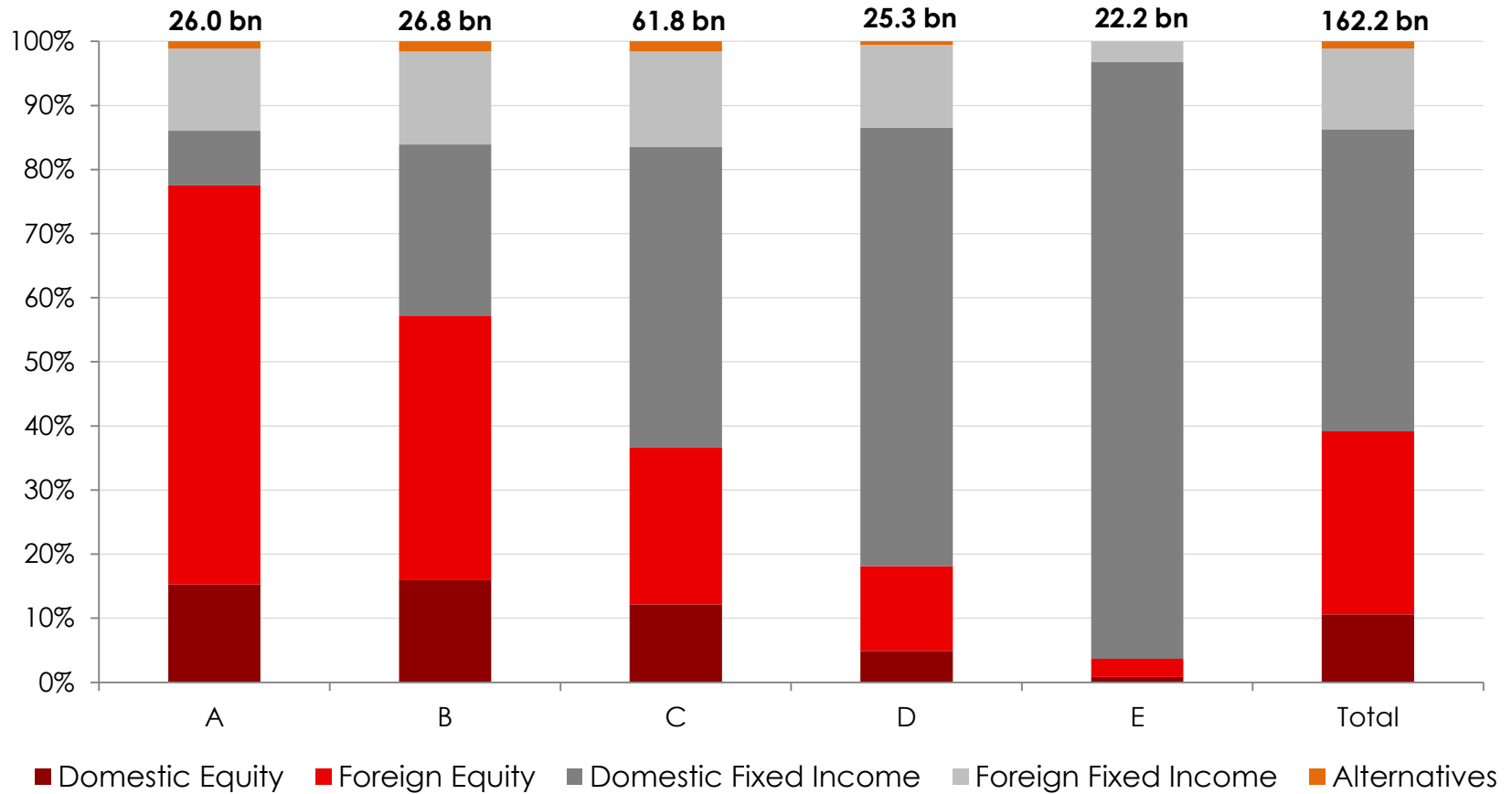
► Multifund Asset Allocation

- > Maximum total foreign investment for funds A+B+C+D+E is 80% of total assets.

















► Fund	► Minimum	► Maximum
A	40	80
B	25	60
C	15	40
D	5	20
E	0	5

► Pension Fund current Allocation

Data in USD billion



▶ Default Path & Fund Options

	Men			
	35 or youger	Between 36 and 55	Older than 56	Retirees
	Women			
	35 or youger	Between 36 and 50	Older than 51	Retirees
A				
B	Default			
C		Default		
D			Default	Default
E				

► Challenges & Current Issues

- > Focus on Replacement Rate or Risk Profile?
- > Default Path
 - > Choice v/s “implied guarantees”
 - > “Once you choose you are on your own”
- > Multi asset funds as building blocks
 - > Investment guidelines based on asset class and issuer limits
 - > Role of Alternative Investments
 - > Peer group competition
- > Pricing not a relevant issue for informed / high income participants
 - > Fees on contributions v/s AUM
 - > Service
 - > Performance
 - > State owned AFP

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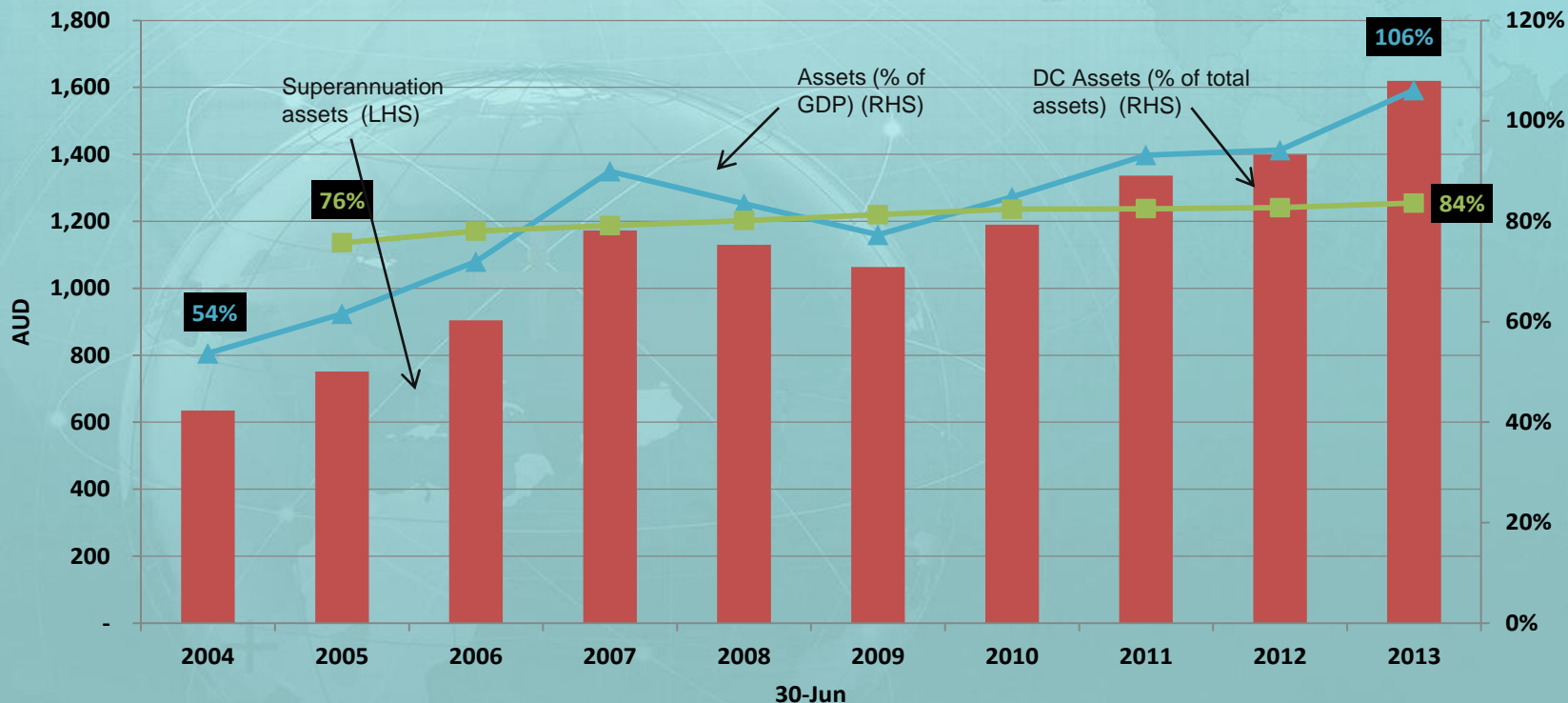
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Australian System – a Snapshot



- Mandatory employer contributions commenced in 1992
 - » now 9.25% of earnings, increasing to 12% by 2023
- No mandated income stream in retirement
 - » investment defaults must cater for both “to” and “through” investors

Member Choice Occurs at Two Levels

- An individual employee may choose:
 - » the fund to which employer contributes (“fund choice”)
 - » investment option(s) within their chosen fund (“investment choice”)
- Default funds are typically selected by employer, or (in unionised sectors) through industrial agreements
- Default investment option (and other default settings) is chosen by the fund operator or trustee

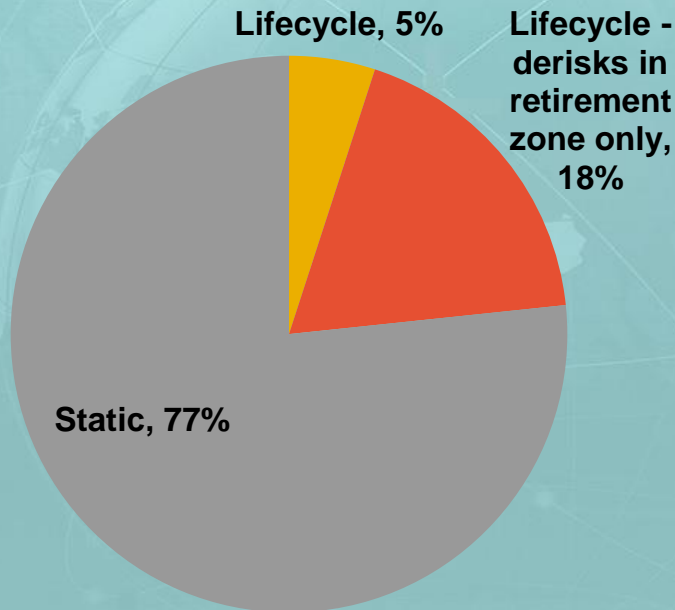
MySuper – Commenced 1 July 2013

- Standardised product offering for funds accepting default fund members
- Investment default must be diversified or lifecycle
- No fee cap, but
 - » uniform fees for all members
 - » limits on types of fees
- Standardised member reporting (returns, fees, risk)
- Default insurance cover

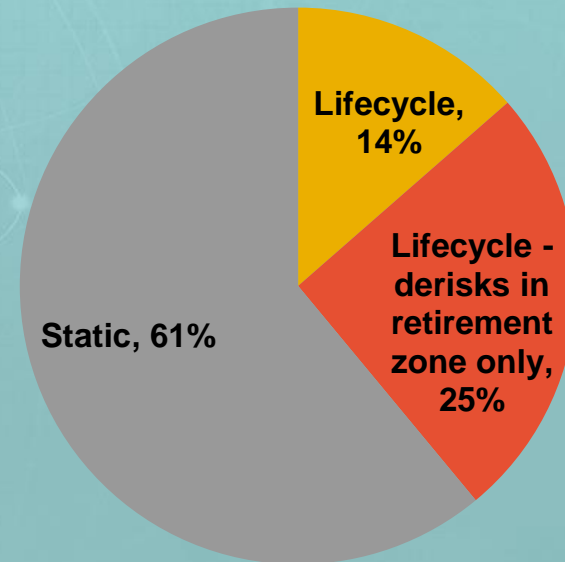
Default Design – Static vs Lifecycle

Not-for-profit funds only

2009



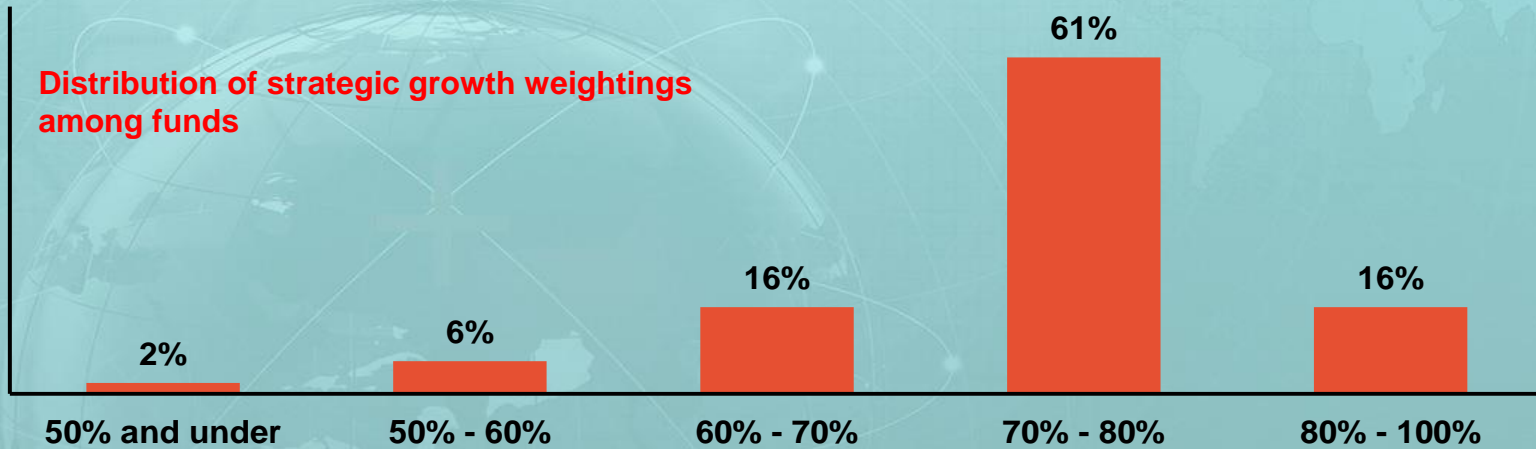
2013



- Some growth in age-based lifecycle
- Some “lifecycle” funds are static in accumulation phase, derisk in retirement phase only

Default Option Asset Allocation

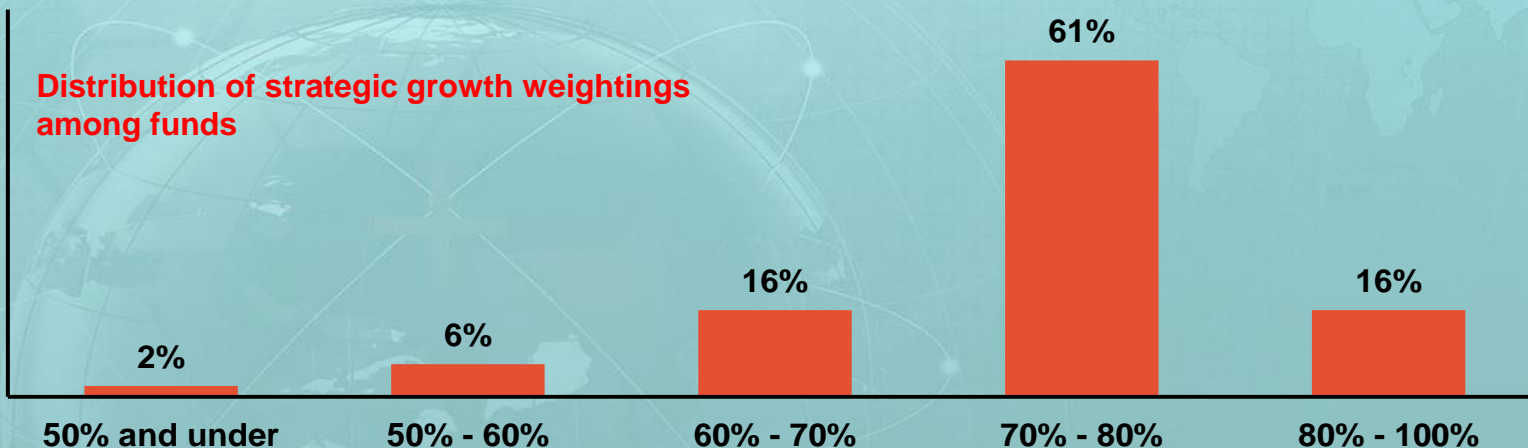
Not-for profit funds with static defaults only, 2013



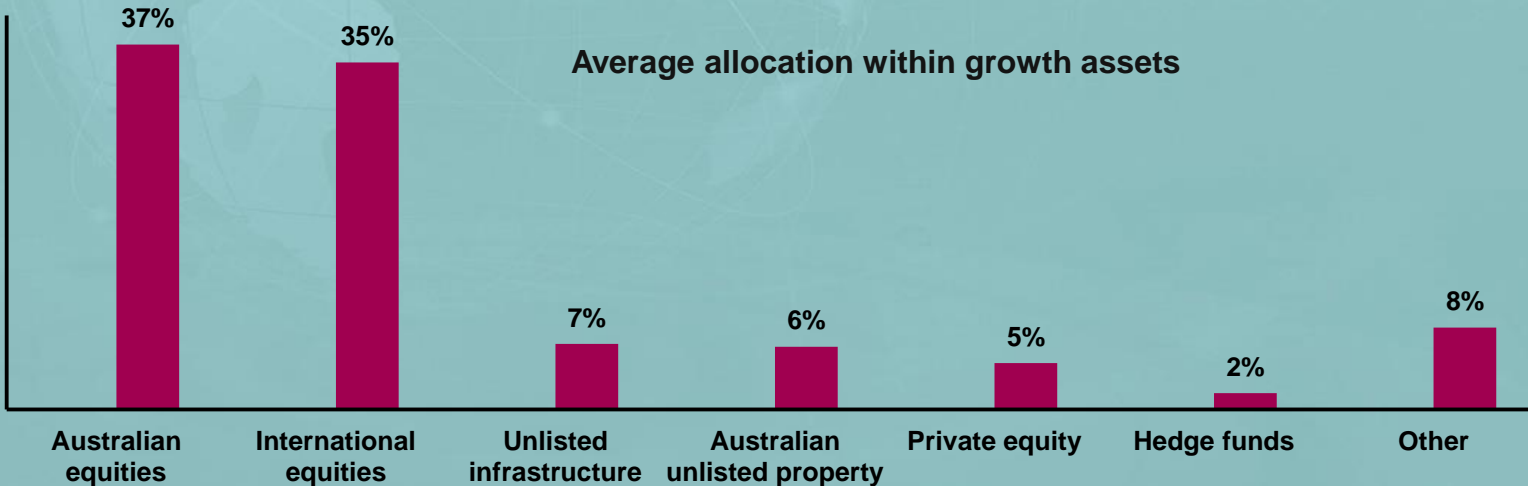
Default Option Asset Allocation

Not-for profit funds with static defaults only, 2013

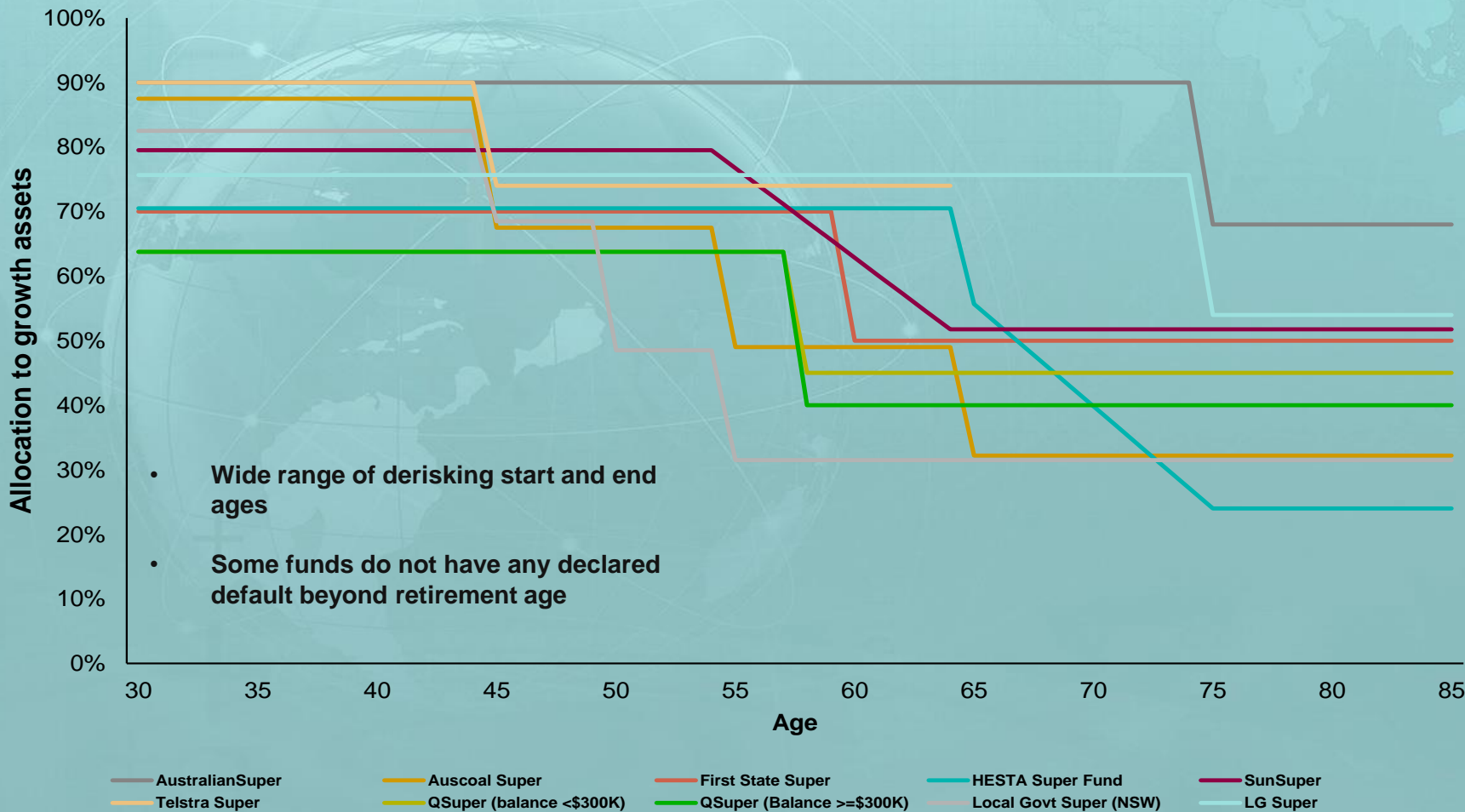
Distribution of strategic growth weightings among funds



Average allocation within growth assets



Lifecycle glidepath design



Topical Issues – Default funds

- Focus on fees and pressure on inclusion of expensive asset classes (e.g. alternatives)
- Provision of annual estimate of retirement income
- Better illustration of investment/retirement outcome risk
- How to mitigate sequencing risk in retirement risk zone
- ‘Dynamic’ or ‘adaptive’ lifecycle

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2014 Global Retirement Savings
Conference, Geneva
18 June 2014

Use of Default Vehicles - The Swedish case of AP7

Richard Gröttheim
CEO AP7



The Seventh Swedish National Pension Fund

- Acts within the defined contribution system which is a part of the government pension plan
- Manage premium pension means, mainly for those that do not appoint a private fund manager “The default fund”
- AP7 has been invested since September 2000
- A new setup, Såfa since May 2010
- Has the same investment rules as a private mutual fund

Some restrictions on what we can invest in

- Equities
- Bonds
- A part in private equity (max 10% commitments)
- ...and there is a equity risk premium i.e. equities will over longer periods give better returns than bonds
- Then you need to take the financial risk i.e. The volatility in the assets



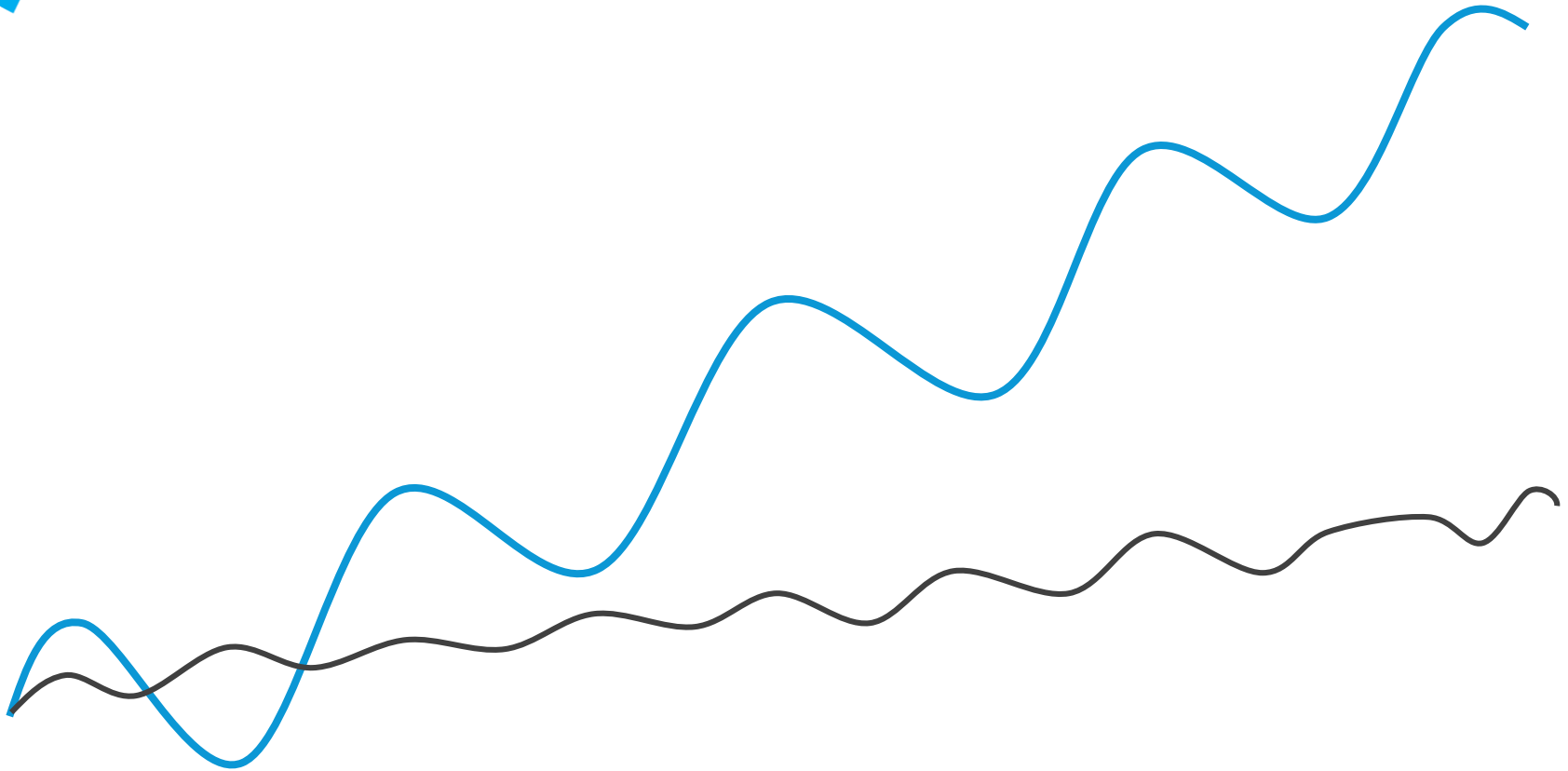
***The mission** - Those who do not want or can't choose should have just as good a pension as others*

Good pension is our contribution to creating security ...

- We shall minimize the likelihood that someone who retires talks to their neighbour and discovers that he/she has a lower state pension than the neighbour
- To get a good pension you need to take financial risk
- We need to glance at the rest of the system (just as good as others)



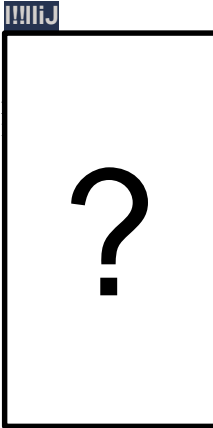
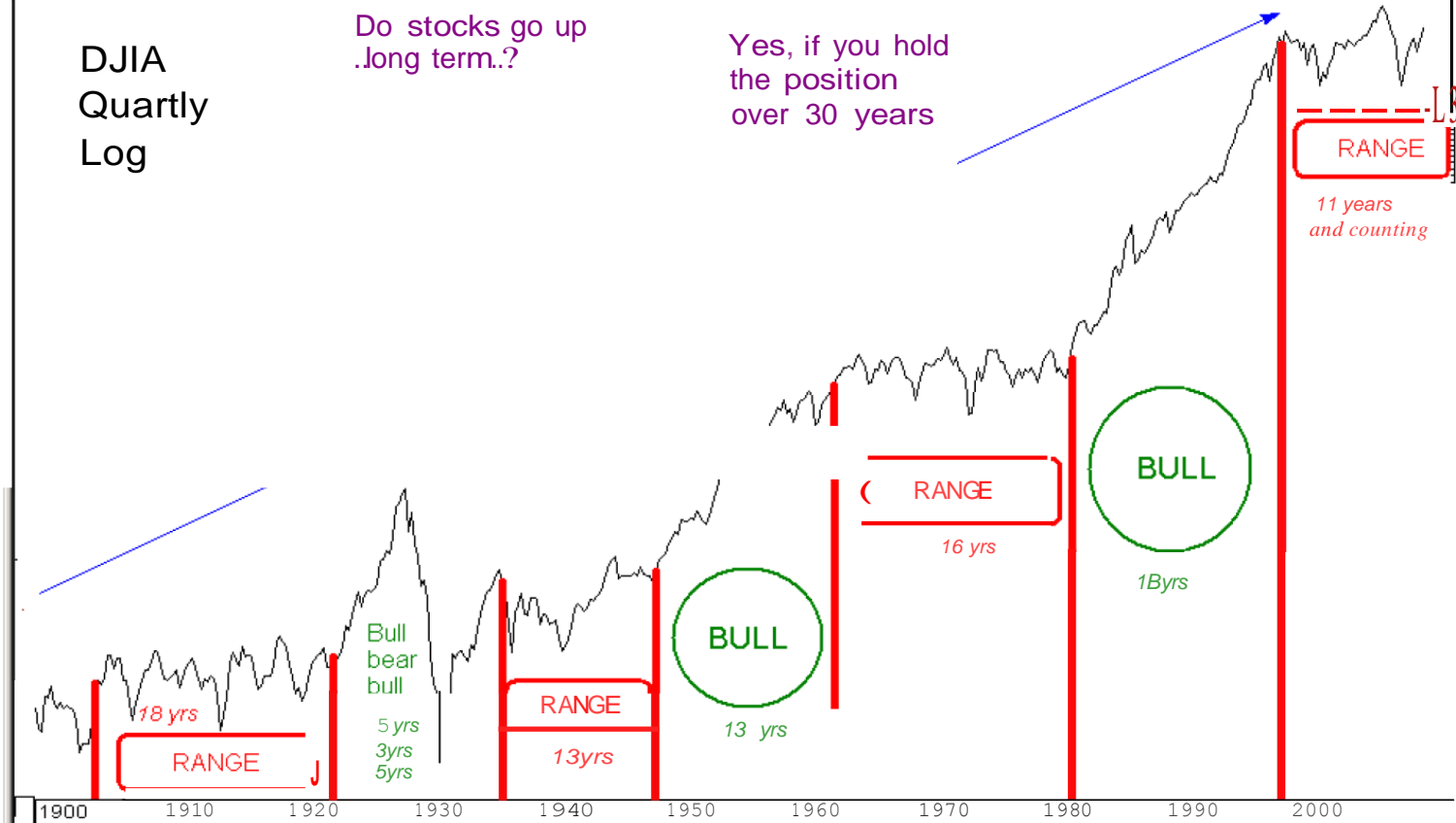
Good pension or low volatility?





In the long run we are all dead...

DJIA - DJ Industrial Average, Quarterly



How did we build the portfolio in 2000?

(AP7 up to. 21st May 2010)



Premium savings fund

Lower risk than the other funds in the system

Target to have a return as good as the average of the other funds

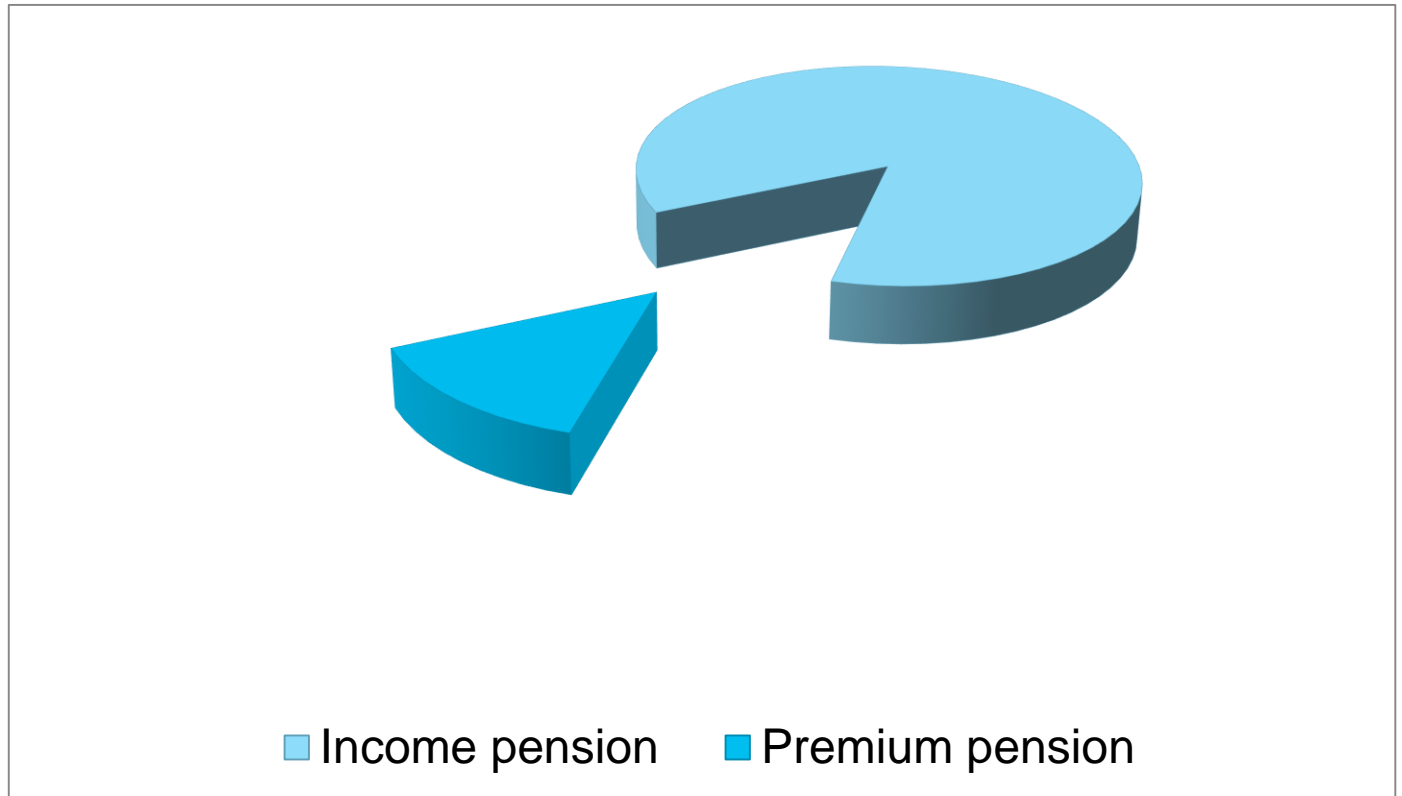
New guidelines in 2009

The default fund

- Holistic perspective on the government pension
- Choice
 - Take in consideration the risk in the income pension
 - Higher total risk level in the premium pension creates possibility for higher government pension
- Lifecycle perspective
 - One product for life
 - Adjust the risklevel to the savers age



Payments to Government pension





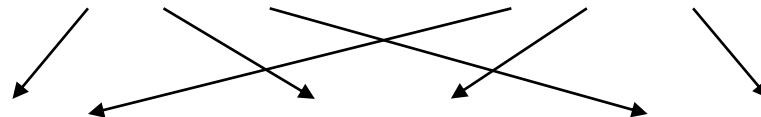
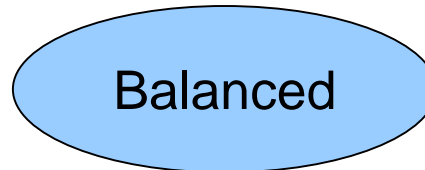
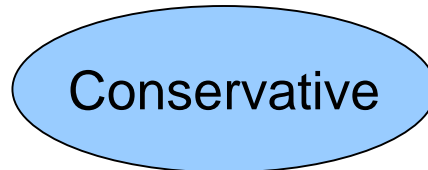
New products

Cohort management



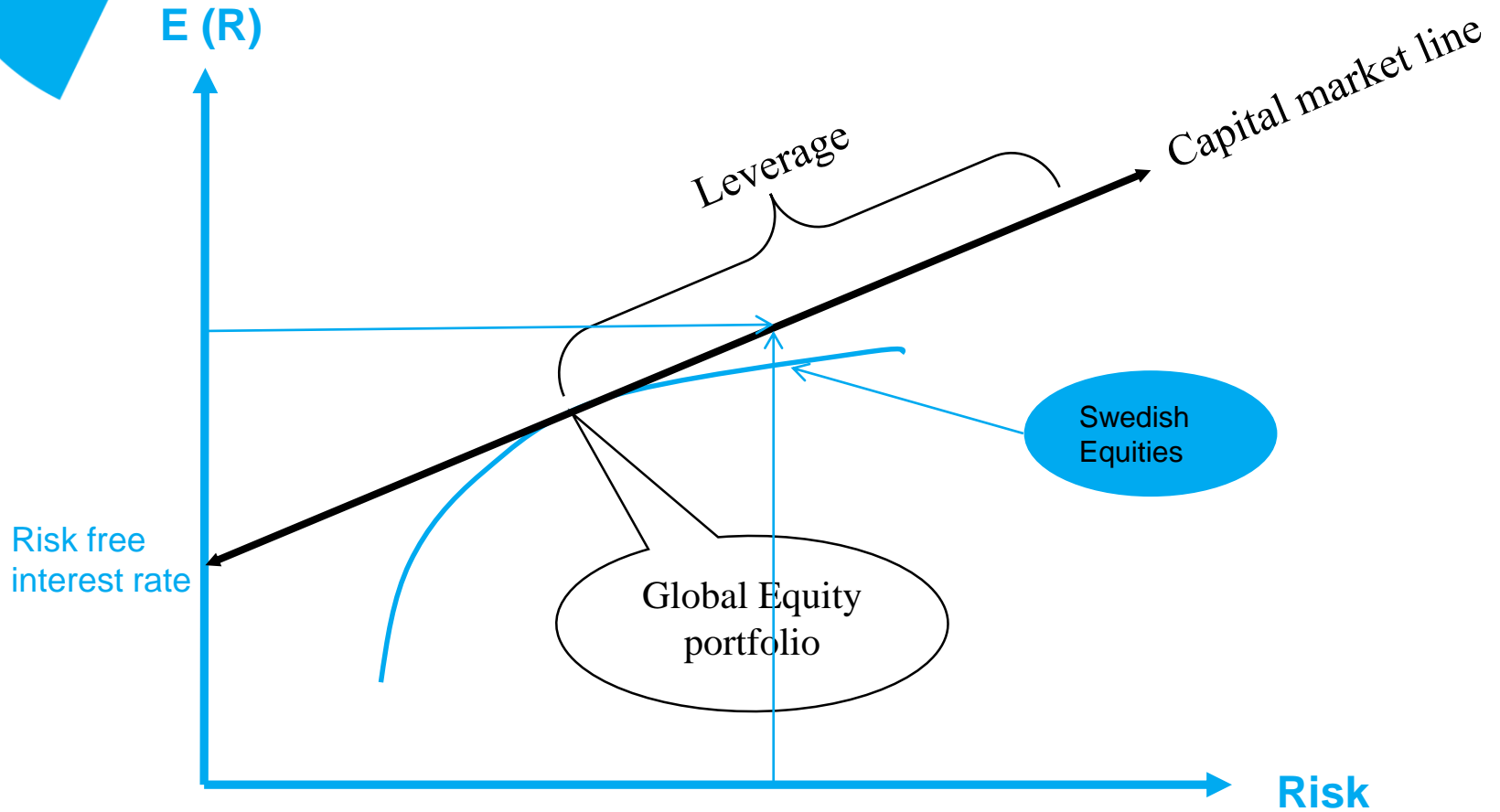
Building block
Funds

Government
Fund
portfolios





The thinking behind the AP7 Såfa





Cohort Management

Risk

1,5

1,0

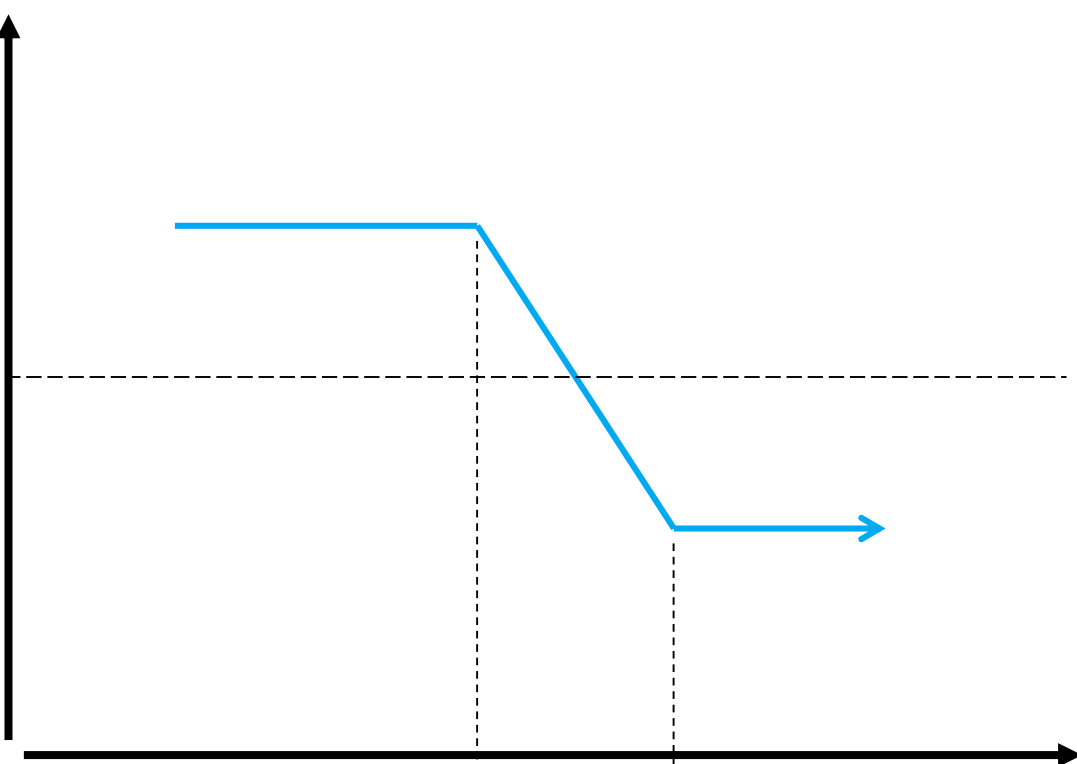
Global Equity Fund

55

75

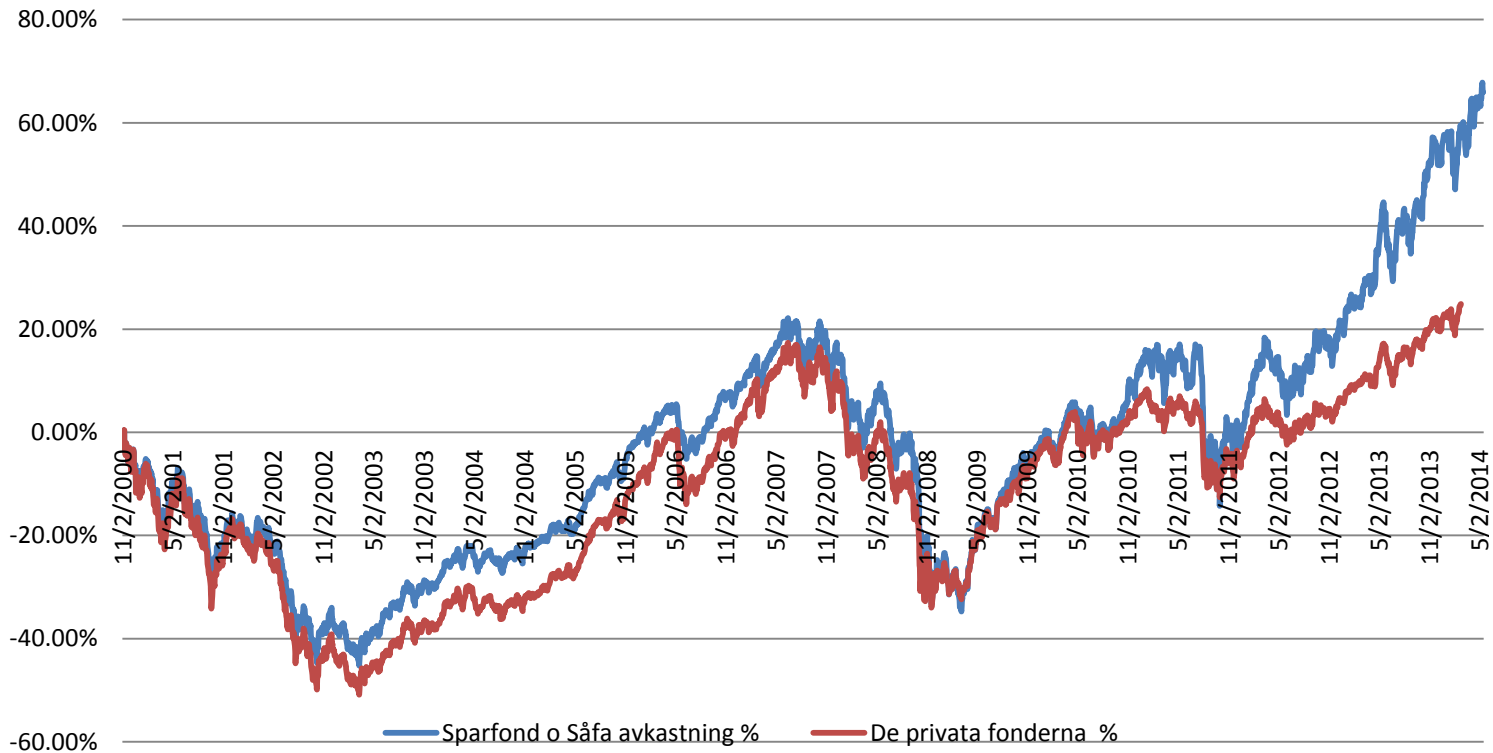
Age

3-4 % yearly decrease in the equity Fund





Return since inception



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Developments in US default funds

Steve Utkus
Vanguard Center for Retirement Research
June 2014

US retirement income system

For private sector employees

Social Security

- First pillar PAYGO
- Contributions: 12.4% (split ER/EE)
- Progressive benefits
- Payouts: inflation-indexed annuity

DC / 401(k) plans

- Voluntary, funded occupational system
- Median 9% contributions (6% + 3%) with great variation
- Payouts: ad hoc or periodic withdrawals or lump sum

Individual Retirement Accounts (IRAs)

- Individually managed accounts offered by all financial institutions
- Recipients of “rollovers” from DC / 401(k) system
- Payouts: ad hoc or periodic withdrawals or lump sum

Default funds in US DC plans

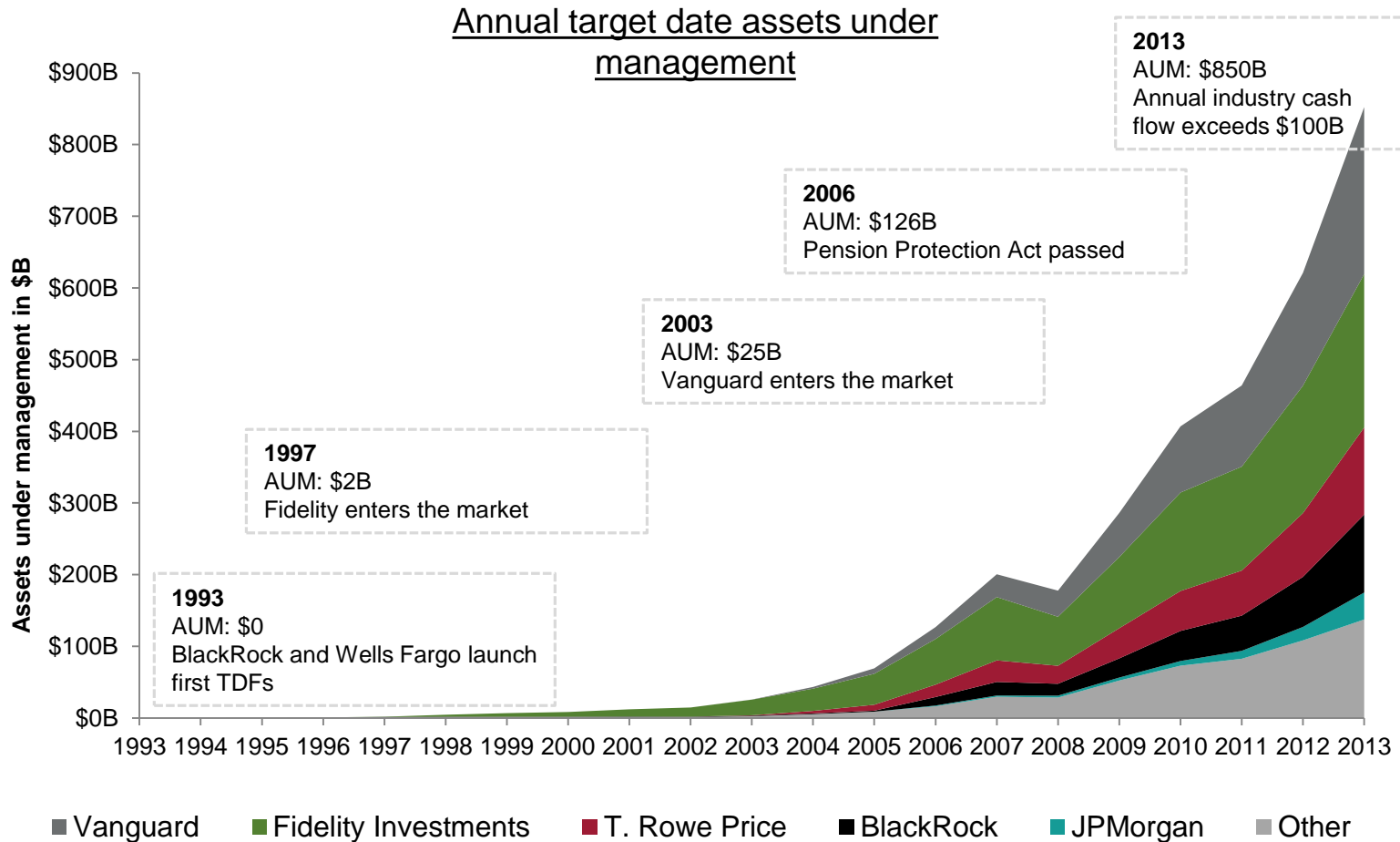
History of 401(k) default fund policy

- Since founding in 1980s, 401(k) plans characterized by high degree of “investor autonomy” (Benartzi and Thaler, 2002).
- Past decade has seen shift toward reliance on defaults, such as default contributions through automatic enrollment (now, >60% of new system entrants).
- In 2006/2007, government authorized new default investments (QDIAs), including target-date funds, traditional balanced strategies, and managed accounts

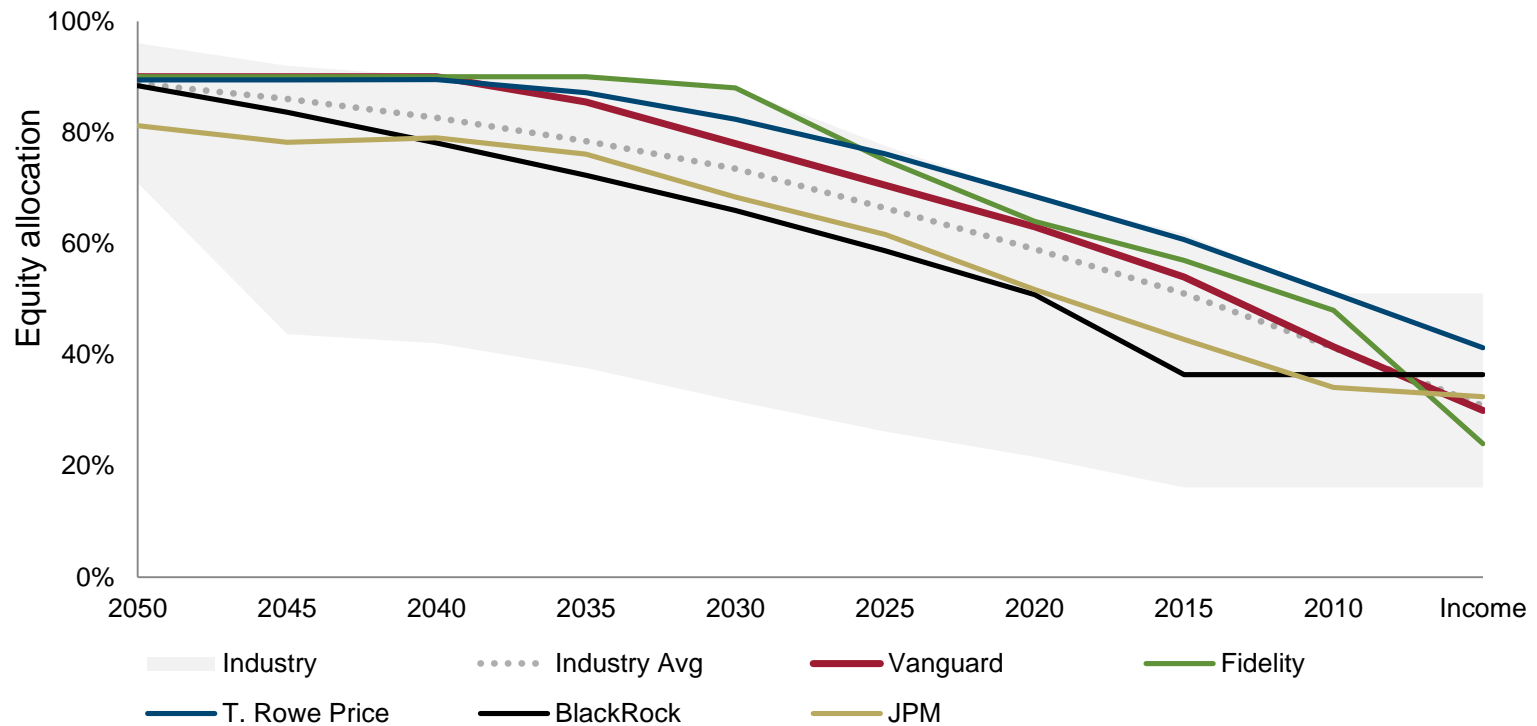
Employer choice of defaults

- Over 85% of DC plans offer target-date funds, and of those selecting a default, over 95% are target-date funds (Vanguard, 2014).
- Target-date assets are expected to reach over half of all DC assets in the coming decade (McKinsey, Cerrulli Associates).

The power of defaults (and voluntary choice)



Target-date glide paths of leading providers



Source: Morningstar, Vanguard analysis.
As of December 31, 2013.

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Contemporary issues in target-date fund design

- Should the glidepath be “to versus through” – are assets used at retirement or throughout retirement?
- What asset diversification strategies are appropriate at each stage of the lifecycle?
 - Liquid market asset classes and allocations to them?
 - Any role for alternatives?
- Should the default be invested with a passive or active approach?
- Should TDF strategies be integrated with a guaranteed income feature? Or will nonguaranteed “drawdown” services suffice?

Important information

For more information about Vanguard funds, call +1 610-669-3348 (collect calls accepted), to obtain a prospectus. Investment objectives, risks, charges, expenses, and other important information about a fund are contained in the prospectus; read and consider it carefully before investing.

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Investments in target-date funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the workforce. The fund will gradually shift its emphasis from more aggressive investments (stocks) to more conservative ones (bonds and short-term reserves) based on its target date. An investment in a target-date fund is not guaranteed at any time, including on or after the target date.

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