

The Ambachtsheer Letter

Research and Commentary on Pension Governance, Finance and Investments

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PERSONAL PENSION ACCOUNTS: FROM MEASUREMENT TO MANAGEMENT

“What gets measured gets managed.”

Peter Drucker

Important Questions

In the 20th Century, most retirement savings were housed in collective DB plans. In the 21st Century, most retirement savings will be housed in personal pension accounts. These accounts may be individually-held/managed arrangements, or they may be part of collective arrangements such as employer-, industry-, or government-sponsored DC or other forms of capital accumulation plans. This sea-change in how retirement savings accumulate, and are managed, raises important questions for how investment performance should be measured. What should be measured? How and to whom should results be presented? When should performance measurement results lead to action? Who should decide?

This *Letter* addresses these questions. The most important conclusions reached are (1) that collective arrangements for managing personal pension accounts should ‘a priori’ produce materially superior investment results relative to simply leaving retirement savers to their own devices, and (2) that they in fact do so in practice. We have made the ‘a priori’ argument why this should be the case on a number of previous occasions. Here we provide new evidence that these predicted superior investment results also materialize in practice. The *Letter* closes with some thoughts on the public policy implications of these realities.

Why Collective Arrangements Should Do Better

The ‘should do better’ argument is straightforward. Its logic underpinnings are information economics, behavioral finance, and principal-agent theory. Individual investors are generally unaware of the consequences when information and knowledge is unequally distributed between them and the firms from which they buy investment services. The investment services market in fact suffers from severe information/knowledge asymmetry, leading to asymmetrical outcomes for buyers and sellers. Specifically, if investment firms know more about what they are selling than retirement savers know about what they are buying, the firms will earn too much in relation to the value they are producing. Investors will pay too much for too little. Their own dysfunctional behavior compounds the problem as many investors fall victim to self-inflicted ‘buy high-sell low’ strategies.

Principal-agent theory offers the foundation for addressing these information- and behavior-related problems. It reminds us that the financial interests of principals (i.e., retirement savers) and agents (i.e., investment firms) do not naturally coincide. Thus incentives must be consciously designed so that agents are motivated to act in the best interests of the principals. This is best accom-