

RETIREMENT REFORM

BE A PART OF IT.

WHEN IS BIG, BIG ENOUGH ?

Study on economies of scale in SA retirement funds

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Economic
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MOTIVATION

How cost-efficient is the SA retirement industry?

- Ultimately, high administrative costs reduce retirement income
 - For DC funds, high costs reduce investment returns
 - For DB funds, high costs impoverish the sponsor as well
- Any national social security system will build on the existing one
- *Equivalent question:* is least cost provision of pension services achieved by having relatively fewer, but larger pension funds?

Estimate a cost function for the entire PF industry

- Methodology used in other countries such as USA or Netherlands
- Estimate a *cost function* taking into account the determinants of administrative expenses such as fund size, fund type, benefit structure, etc ...
- Administrative expenses vary with both investment activities and services to members in the pension plan:

$$\ln Cost_{it} = \alpha_0 + \alpha_1 \ln Members_{it} + \alpha_3 Assets + \sum_j \alpha_j X_{jit} + \varepsilon_{it}$$

- α_1 = scale coefficient
- When $\alpha_1 < 1$: Potential efficiency gains to be made (decreasing returns to scale)

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INTERNATIONAL FINDINGS

Unused economies of scale between 5.5% - 31%

Country	α_1	Percentage of unused economies of scale
Australia	0.739	26.1%
Canada	0.945	5.5%
Netherlands	0.691	31%
USA	0.788	21%



Source: Bikker, Steenbeek and Torracchi (2010)

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DATA

Pension funds reporting to the FSB, 1996-2006

- Sample is drawn from FSB data on Audited Financial Statements
- Period of study: 1996 - 2006
- Only private funds are considered, not underwritten funds
- Sample consists of 13,652 data points
- Detailed breakdown of administrative expenses, membership, ...
- Data are from a “fee” perspective (charges to clients not costs)

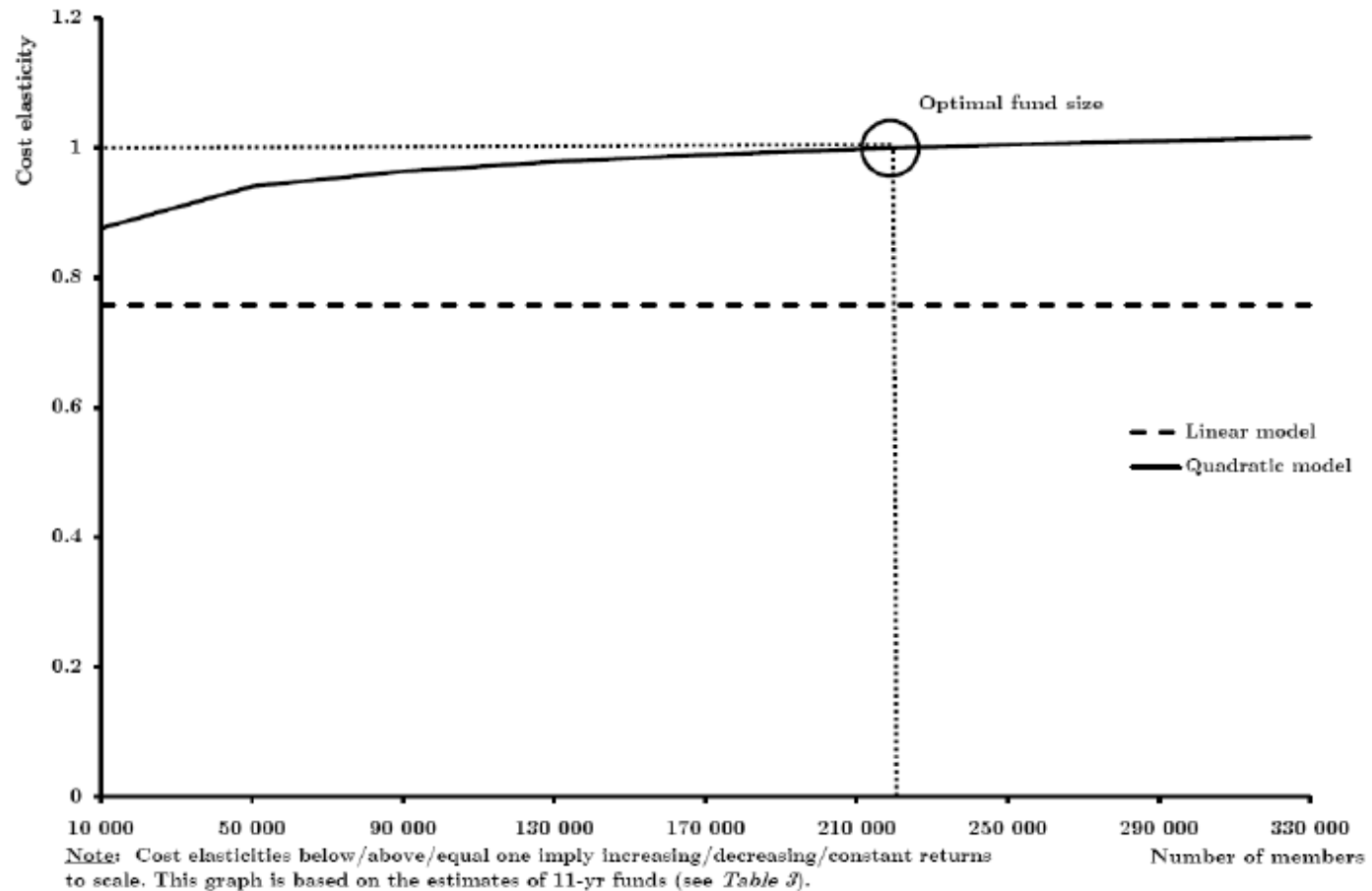
How cost-efficient is the SA retirement industry?

1. Between 24% and 30% of unused scale economies
 - The scale coefficient, α_1 , lies between 0.69 and 0.76
2. Old pension funds are more efficient
3. The optimal fund size at around 220,000 members
4. The industry was more “scattered” in 2006 than in 1996

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Findings

Estimate of the optimal pension fund size in SA



Findings

Overview of concentration in the PF industry

The industry was more “scattered” in 2006 than in 1996

