Active Investment Decisions of Members in the Chilean DC Pension System: Performance and Learning over Time

discussion by

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29 January 2014

Chili's Mandatory DC plan

Available investment menu has five funds, varying in their proportion invested in equity.

Funds B (60%), C (40%), D (20%) are default options, depending upon age. Pension wealth is (automatically) reallocated across these three over the life-cycle.

Investors can decide to reallocate and deviate from the default options, where funds A (80%), E (5%) are optional (voluntary).

What makes investors change? Do these changes enhance their performance?

General comments

The paper paints an interesting picture of the Chilean pension system, and its investors.

To fully understand what's going on, some more institutional details and descriptives are helpful.

Large cross-sectional data set (administrative data of 6M+ individuals), but time window is limited (2008-2013).

This may be short to evaluate (ex post) performance and relate it ex ante decisions.

(It appears the cumulative real return on equity was about -15% in this period, probably well below the long-run average (equity premium).)

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Institutional setting: questions

- Not clear whether investors can diversify across funds. Only on p. 17 it is mentioned that two funds can be combined.

- Do investors decide on new money only or can they adjust existing portfolio only? (The latter.)

- Are there any costs to switching?

- What is the default path of reallocations? How is this incorporated in the study?

- Apparently, investors can also have a voluntary account. What separates the "mandatory account" from the "voluntary account"?

Confusing descriptives (please help me)

Descriptive statistics mix individual level and observation (individual/year) level. This is confusing.

E.g. Table 3 reports 2.2% of 6,199,000 (= 136,000) individuals making changes in 2008, while Table 4-6 report 461,779 affiliates with changes in the same year.

Table 3 reports that 2.1% of 21,621,374 males make changes (= 454,000), plus 1.6% of females (=250,000).

Then, Table 4 reports that 1,755,645 male/years on average have 0.45 changes (aggregating to 790,000), while subsequent tables use 463,587 individuals with changes.

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Questions

- Number of individuals in the panel is surprisingly constant. Entry and exit?

- Why do quintiles contain uneven numbers of observations? E.g. mandatory account balance in Table 3. (I am probably misinterpreting something here.)

- Do investment funds differ substantially in their equity allocations and performance? Do individuals reallocate on the basis of (perceived) skill, or just on %equity?

Remarks

- Provide clear empirical definitions of variables, e.g. "contribution density".

- Given 6,000,000+ observations almost any difference will be "statistically significant" at 5% level. Also spend some time discussing whether such differences are economically meaningful.

- International audience will appreciate some info on value of Chilean currency. Average taxable income of $ 326,252 is roughly US$ 600 (per year?), is that correct?

Determinants of fund changes: questions

- Why not use conditional logit to include the returns per fund (or other fund-specific characteristics), to explain probability of changing to this fund?

- How are marginal effects defined (and interpreted) for dummy explanatory variables (gender)?

- How is the time-dimension dealt with? Or is this actually a cross-sectional model (pooling all time-periods) or a simple pooled model?

- Explore a simpler model: what makes individuals increase or decrease their allocation to equity?

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Transition analysis: questions

- The transition matrix in Table 14 is a bit hard to interpret.

- One reason is that the number of observations across brackets (in the aggregate) are not the same. (Not clear why, definition?) Positive or negative persistence is therefore hard to observe.

In summary

- Interesting paper about interesting pension design.
- Pay more attention to institutional details and give clear working definitions of concepts and variables.
- Pay attention to economic meaning of the results.
- Use "alphas" to evaluate performance, rather than, or in addition to Sharpe ratios.
- Any scope for expanding the time window?
- Try to extract general lessons from these results. What do we learn about investor's behavior in pension funds that we did not know?

In summary

- Previous studies indicate that inertia among pension fund investors is high.

- This study suggests that being inert may be attractive, because individuals that made active investment decisions did poorly.

- Can performance be enhanced by improving default options or the design? Or by better informing individuals?

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