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Wealth Transfer in Long-Term Saving Products: The Role of Alternative Assets

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Introduction

- Pension funds around the world have been increasing their allocations to alternative assets, especially to private equity, venture capital and other types of private funds.

- Given their illiquidity, the market value for these assets is assessed at a lower frequency than that of publicly traded securities.

- According to OECD (2020), members in individual DC pension schemes often have significant flexibility in deciding how to invest their retirement savings and even change their decision over time and transfer their accumulated balances to different investment strategies.

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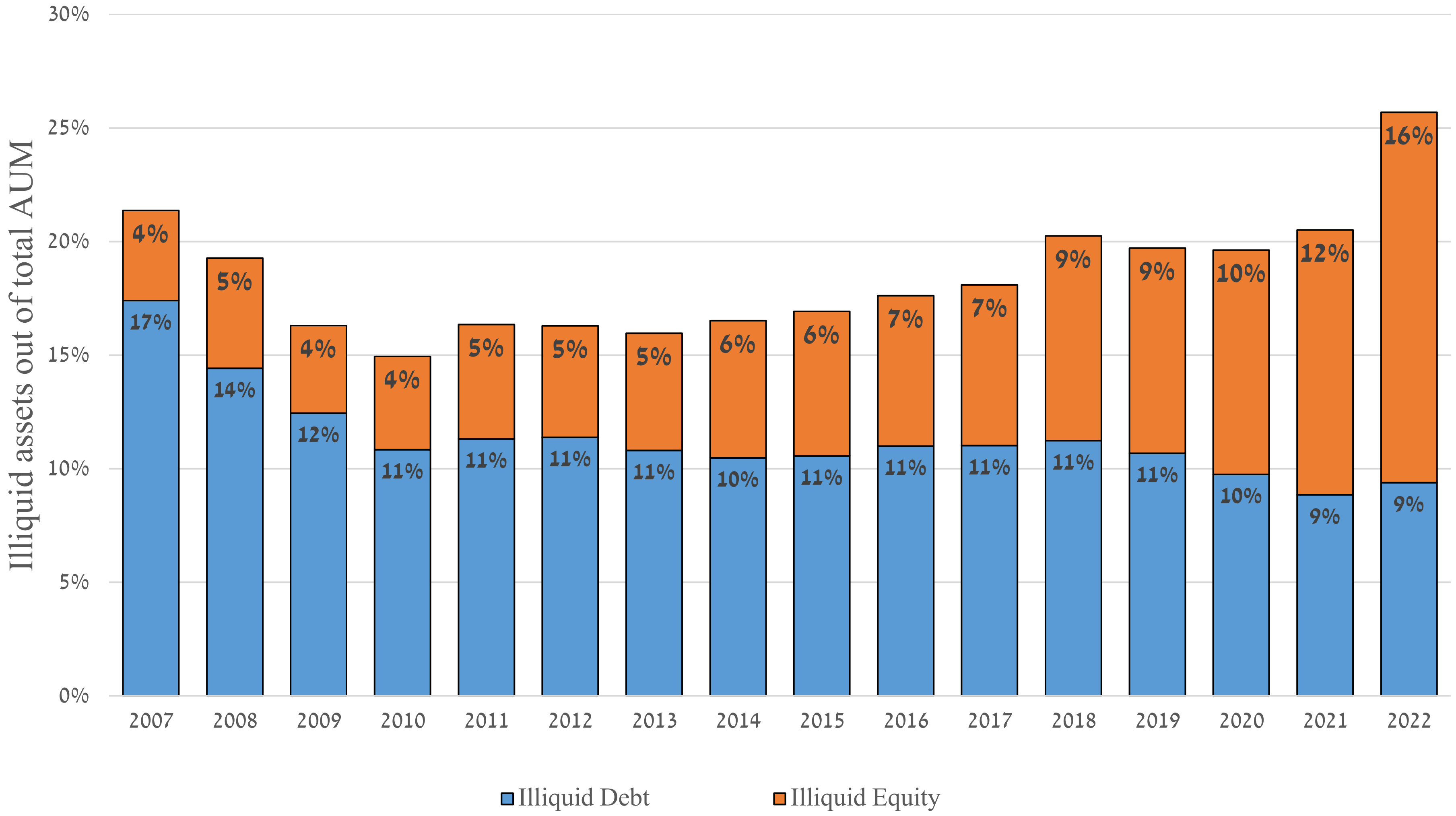
Investments in Alternatives among Israeli Institutional Investors



Correlation of Alternatives with the Tradeable Market

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Paper	Jegadeesh et al (2015)	Driessen et al (2013)	Korteweg and Nagel (2016)	Ang et al (2017)	Jegadeesh et al (2015)	Driessen et al (2013)	Ang et al (2017)
VC or BO	*VC*	*VC*	*VC*	*VC*	*BO*	*BO*	*BO*
Market beta	0.9-1.0	2.4-2.7	2.7	1.5-2	0.7	1.3-1.7	1.2-1.8
HML	insig (pos)	insig (neg)	-	-0.6	insig (pos)	1.4 (insig)	0.5-0.7
SMB	0.5	insig (pos)	3.7	0.8-0.9	0.5	insig (neg)	insig (pos)
Liquidity (PS)	-	-	-	insig (pos)	-	-	0.6
Momentum	-0.1	-	-	-	0	-	-
PE-specific factor	no	no	no	yes	no	no	yes
"Alpha"	0	-1%	-10%	-5%-0%	0	insig (neg)	-4%-4%

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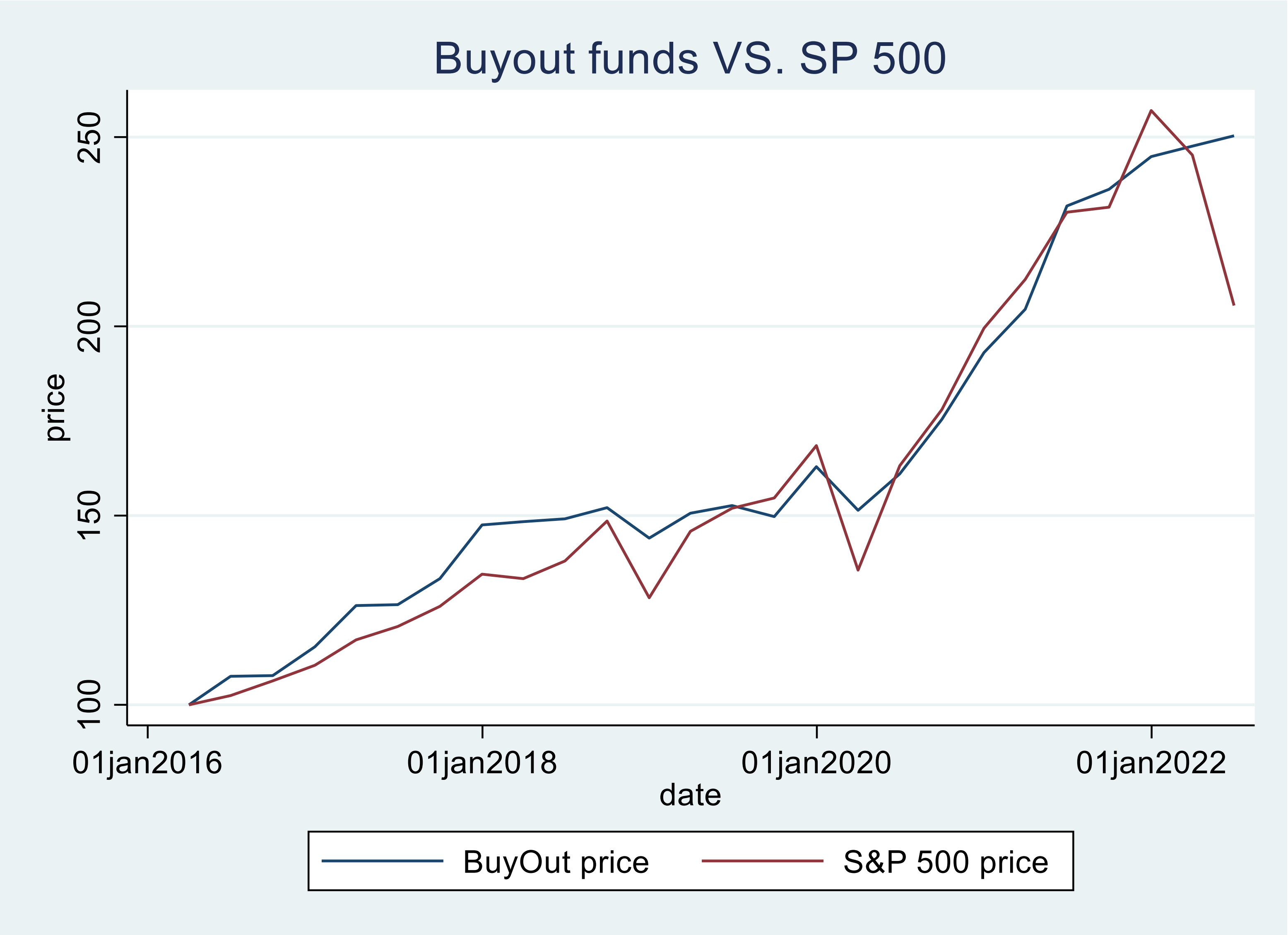

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What Impact does the Frequency of Evaluations have on Pension Savers?

wealth transfer problem can exacerbate in the occurrence of three main factors:

1. A substantial allocation of illiquid assets in the pension system.

2. Severe declines in markets which doesn't reflects immediately in the value of the illiquid assets.

3. Substantial withdrawals or switching between funds with high rate of illiquid assets to funds with low rate of illiquid assets.

How to Define Wealth Transfer?

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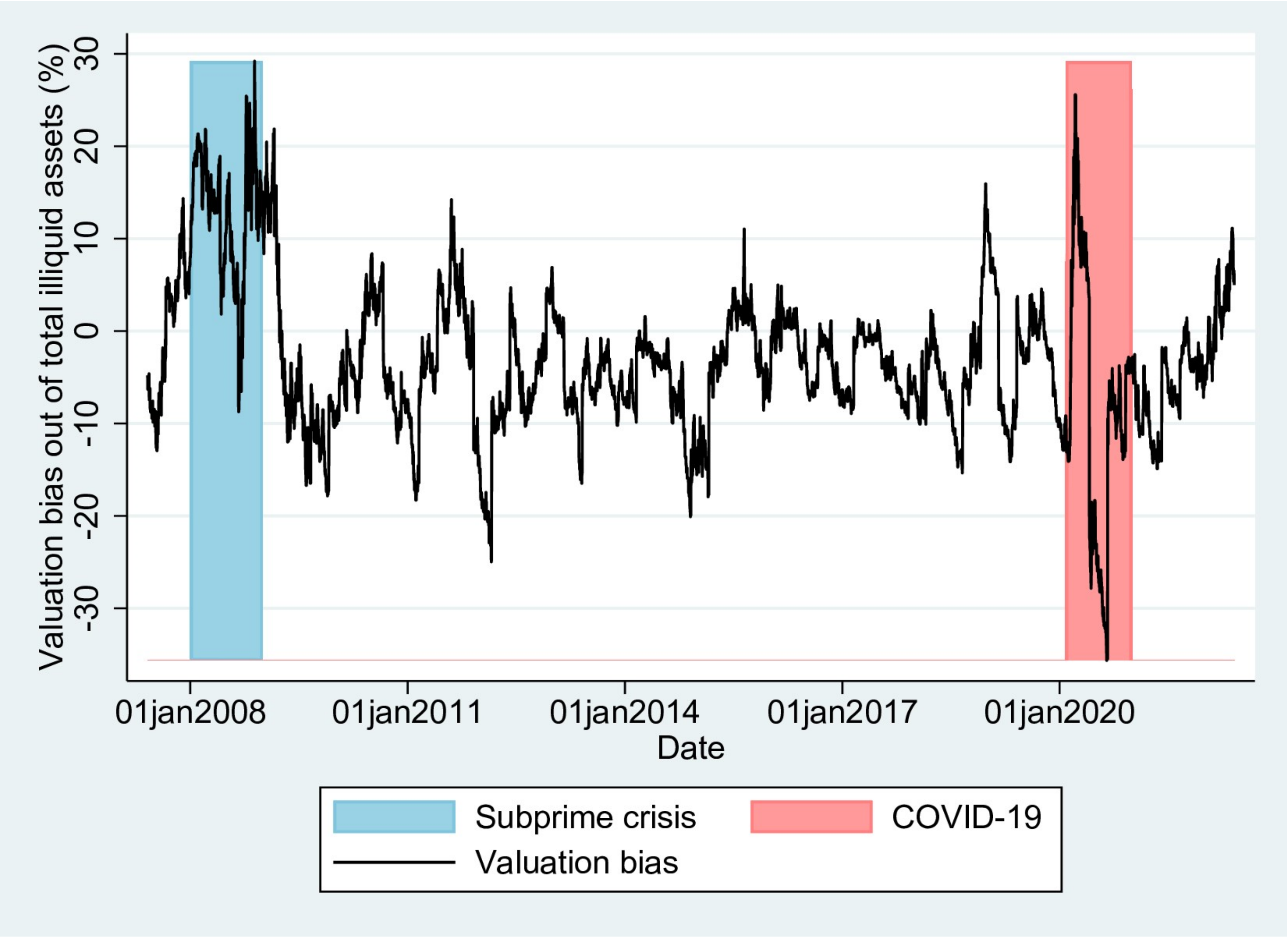
The methodology is based on estimating the differences between the value of the illiquid assets according to the last known valuation and estimates of the actual, or correct, value of these assets, which I compute by assuming plausible values of beta between each illiquid asset class and the relevant benchmark:

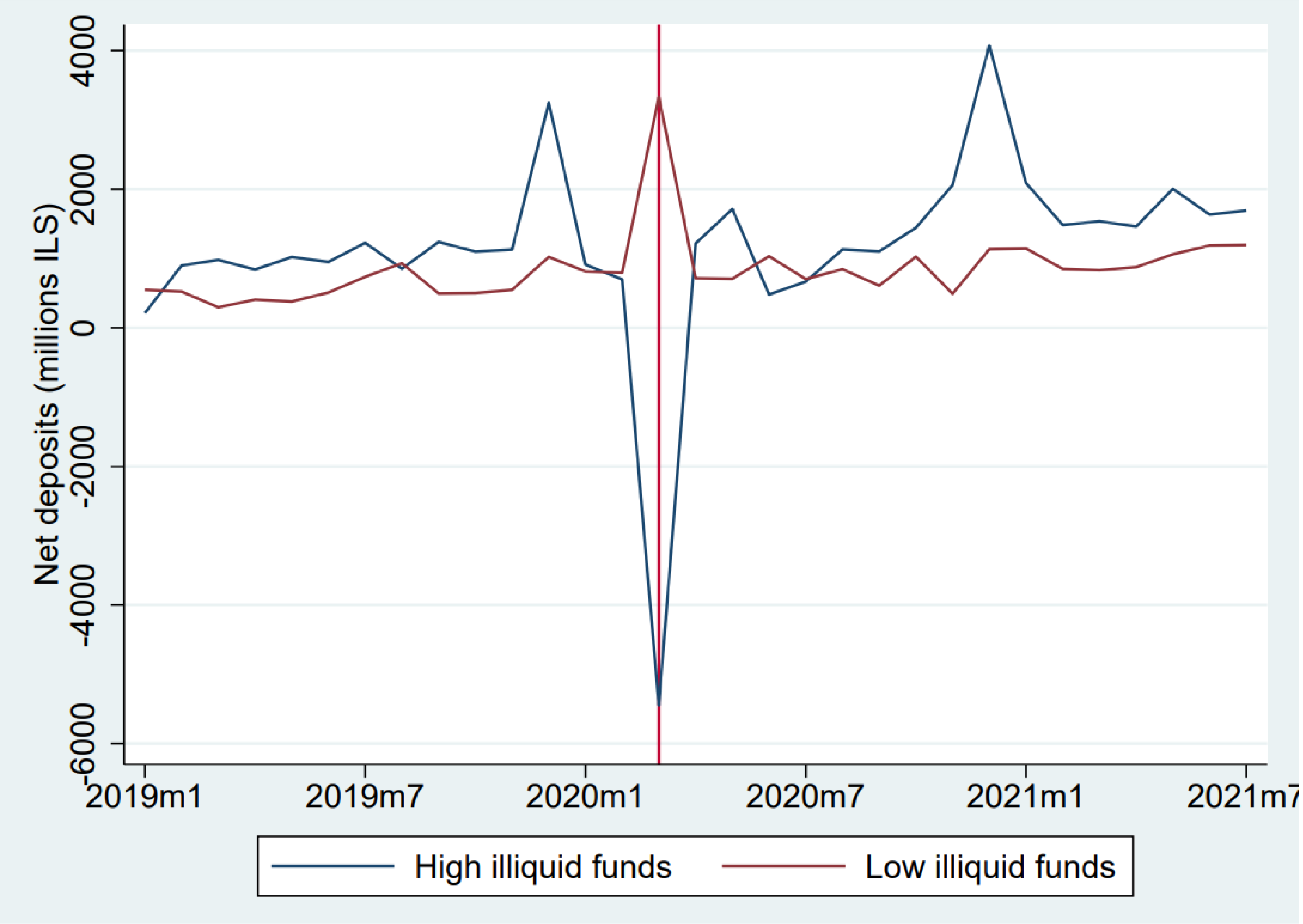
$$Wealth\ Transfer = \sum_{i=1}^{n}\left[\left(V_{1,i} - \beta_i * yield_i * V_{1,i}\right) - \left(V_{2,i} - \beta_i * yield_i * V_{2,i}\right)\right]$$

- $V_{1,i}$ is the value of asset class according to the last reported valuation
- $V_{2,i}$ is the value of the same asset class in the fund after the transition

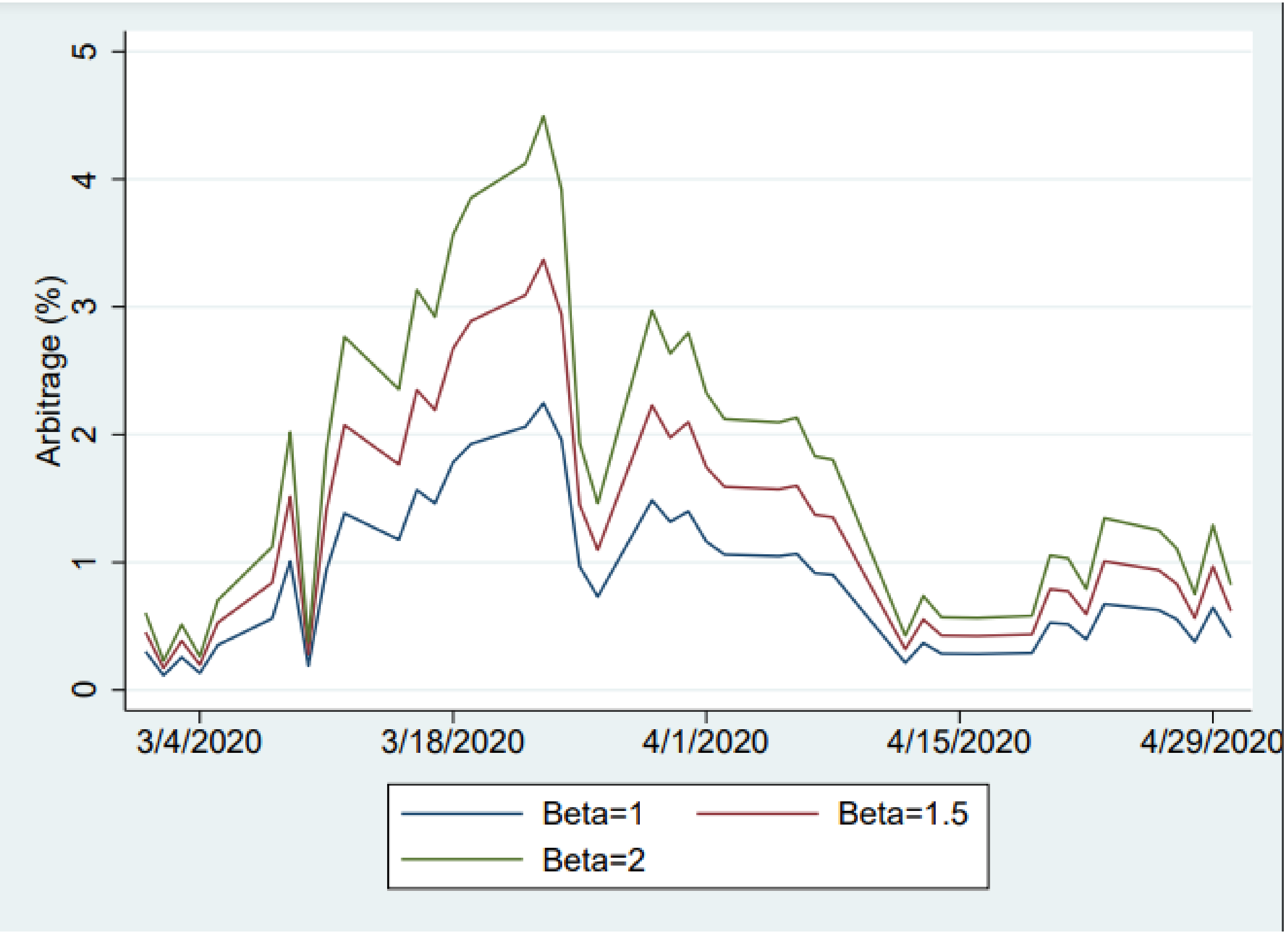
Theoretical Value of Wealth Transfer



Flight to liquidity during the COVID-19



Estimation of Wealth Transfer During the COVID-19



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How this Issue Should be Addressed?

- Prohibit switching savers between investment strategies during periods of extreme volatility?

- Evaluate equity illiquid assets daily? (Just like illiquid debt)