

International Centre for
Pension Management



The Ideal Pension Delivery Organization – Theory and Practice

Keith Ambachtsheer
March 22-23 2007

DNB / Netspar / IoPS Conference
Amsterdam

“Legitimacy” = “TOPS”

- Pension formula that is transparent / sustainable
- Broad workforce coverage
- Arms-length, expert pension delivery organizations (PDOs)

Agency Theory

- 1933 Means and Berle "The Modern Corporation and Private Property"
- 1936 Keynes "The General Theory"
- 1970 Akerlof "The Market for Lemons"
- 1976 Drucker "The Unseen Revolution"
- 1992 O'Barr and Conley "Fortune and Folly"



Estimates of Agency Costs: Pension Funds vs. Mutual Funds

	GVA	MER	NVA	T-Value
CDN Pension Funds (DB)	1.5%	0.3%	1.2%	8.1
CDN Mutual Funds	0.2%	2.8%	-2.6%	-15.2
US Pension Funds (DB)	0.2%	0.3%	-0.1%	-1.5
US Mutual Funds	-1.6%	1.2%	-2.8%	-33.3
US Pension Funds (DC)	0.2%	0.6%	-0.4%	-4.6
US Mutual Funds	-1.3%	1.2%	-2.5%	-28.1

Source: Bauer, Frehen, Lum, Otten (2007) "The Performance of US Pension Funds: New Insights into the Agency Costs Debate"



Governance Theory

- 1976 Drucker "The Unseen Revolution"
- 1992 O'Barr, Conley "Fortune and Folly"
- 1995 Ambachtsheer, Boice, Ezra, McLaughlin "Pension Fund Excellence: What Is It?"
- 1997 Ambachtsheer, Capelle, Scheibelhut "Improving Pension Fund Performance"
- 2005 Ambachtsheer, Capelle, Lum "Pension Fund Governance Today: Strengths, Weaknesses, and Opportunities for Improvement"



Characteristics of Responding Pension Funds to 2005 Survey

Region	% (EW) *	% (DW) **
Australia / New Zealand	4%	1%
Canada	41%	13%
Europe	11%	32%
United States	44%	54%
Sponsor Type	% (EW) *	% (DW) **
Corporate	38%	14%
Public Sector	41%	66%
Other	21%	20%
Size	Median	Mean
Billions of \$USD	\$3.7B	\$17.9 B

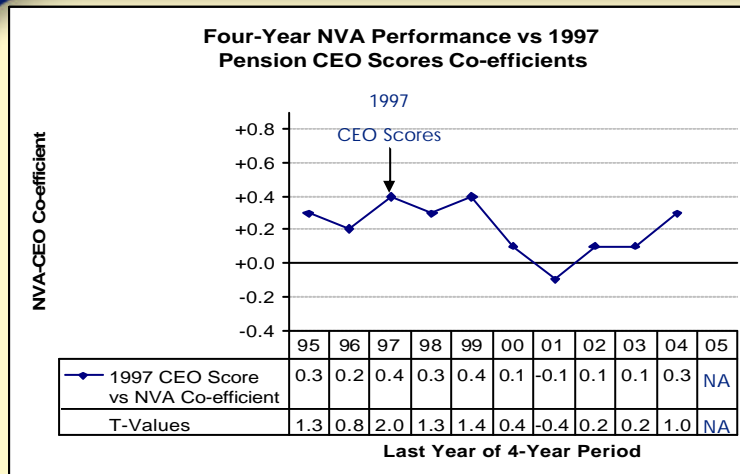
* Equal-weighted

** Dollar-weighted

Source: Ambachtsheer, Capelle, Lum (2006) "Pension Fund Governance Today: Strengths, Weaknesses and Opportunities for Improvement"



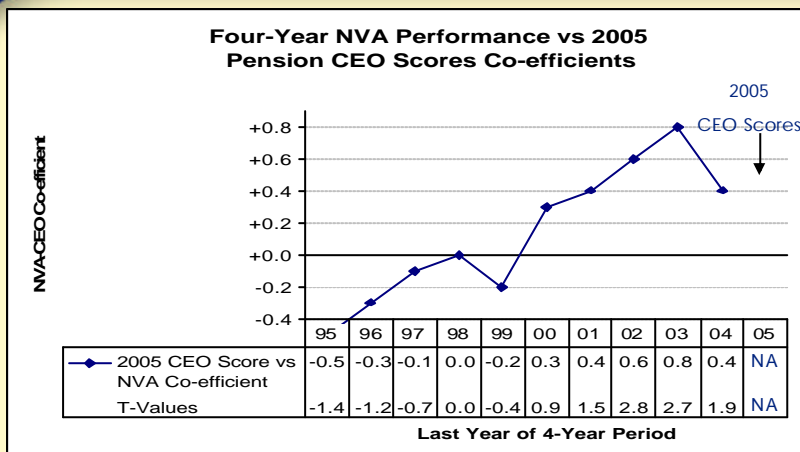
Pension Fund Governance and Performance: Are They Statistically Related?



Source: Ambachtsheer, Capelle, Lum (2006) "Pension Fund Governance Today: Strengths, Weaknesses and Opportunities for Improvement"



Pension Fund Governance and Performance: Are They Statistically Related?



Source: Ambachtsheer, Capelle, Lum (2006) "Pension Fund Governance Today: Strengths, Weaknesses and Opportunities for Improvement"



The Impact of Differing Net Return Experiences on Pension Adequacy

	Net Realized Return			
	4%	2.6%	1.5%	-2%
Annual Savings (over 40years)	\$10,000	\$10,000	\$10,000	\$10,000
Final Savings (after 40 years)	\$988,000	\$707,000	\$551,000	\$272,000
Annual Pension Payment	\$57,000	\$41,000	\$32,000	\$16,000
Working Income Replacement Rate	114%	82%	64%	32%



'Real World' Implications – Part I

Arms-Length

- Dedicated, single-purpose PDOs with the sole mission of creating value for stakeholders

Expert

- Strong governance / professional structures within PDOs

Scale

- Major competitive advantages



'Real World' Implications – Part II

"Create value for stakeholders"



"Generate stable pensions at reasonable cost"



Three Measurable Objectives

1. Generate net excess return at appropriate level of risk
2. Make correct pension payments in timely, cost-effective manner
3. Maintain high trust level through excellent communications



'Real World' Implications – Part III

- Strategic Investment Plan Components
 - Investment Beliefs
 - Risk Budget
 - Target Exposures (LHP, ROP)
 - Organization design
 - HR Plan
 - IT Plan



'Real World' Implications – Part IV

- 'Ideal' PDO Externalities
 - Focus on wealth-creation rather than 'beauty contest' investing
 - Knowledgeable owners insist on effective corporate governance
 - Dampened financial markets volatility
 - Functional merger of capitalism and socialism



Critical Conclusions

The 'Ideal'
PDO

Arms-Length

Expert

With scale

- Generates materially higher pension output per unit of savings input relative to 'non-ideal' alternatives
- Generates material positive externalities
- Does not happen naturally / organically (i.e., needs to be created)
- Is not tied to any particular pension formula

