

The *Ambachtsheer* Letter

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AN ASSET MIX POLICY FOR THE 21ST CENTURY

“Pension fund management must determine a dynamic long term strategy which balances the interests of the plan sponsor and plan members, while satisfying the solvency standards of the regulatory authorities. Thus the available asset and liability policy instruments must be analyzed in an integrated fashion...”

Boender, van Aalst, Heemskerk
from their article “Modeling &

Dutch Treat

Asset-Liability Management (ALM) modeling has been a pension plan decision tool since the early 1980s. Increased use of this modeling technique has improved ALM practices considerably over the last 20 years in the major pension fund countries.

With their vast pension assets and long tradition of integrating academic research and business best practices, the Dutch have been at the forefront of developing ALM best practices. Thus it is appropriate to have Dutch ALM specialists Boender, van Aalst, and Heemskerk set the stage for this *Letter*.

The purpose of this *Letter* is to show how good ALM modeling can lead to more informed asset mix policy decisions. We do this by actually walking four pension plans through the next 10 years, and seeing what we can learn from the experience.

The analyses discussed on the inside pages were constructed with the ALM modeling capabilities of ORTEC Consultants, the leader in this field in the Netherlands. A special ‘tip of the hat’ goes to Fred Heemskerk, who promptly (and cheerfully!)

met requests for additional calculations. The economic and capital markets assumptions came from our January and February *Letters*.

Four ‘What If’ Questions You Should Know the Answers To

The essence of good ALM modeling is to answer critical ‘what if?’ questions quickly and clearly. Four such questions are:

- How much would our pension plan cost if we just matched the liabilities with risk-free assets of similar duration and inflation sensitivity?
- By how much would the cost drop if we adopted a riskier asset mix such as 60-40 equities-bonds?
- By how much would our funded ratio drop if the economy and the financial markets experienced an extended bout of deflation? Of inflation?
- By how much (and for how long) would our contribution rate have to rise to bring our funded ratio back up to an acceptable level in the deflation case? The inflation case?