

The *Ambachtsheer* Letter

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IS 'ECONOMIC VALUATION' THE KEY TO SAVING DB PENSION PLANS?

"...economic valuation is the key to making DB pension schemes

A National Debate

As the world leaders in pension assets per capita, we should not be surprised the Dutch take their 'pensioenfondsen' very seriously. Thus there is an ongoing national debate about what constitutes 'best practice' in the management and valuation of their beloved DB (ie., defined benefit) retirement schemes. This past September 5 marked an important date in the debate, as 125 experts gathered in Amsterdam to discuss the question of whether DB schemes should continue to be valued by rules set by legislation and the actuarial profession, or whether the system should move towards a more transparent, objective 'economic valuation' philosophy.

We were asked to set the stage by sketching out a framework to guide the discussions, and to offer some impressions of where the valuation debate stood in North America. UK actuary Simon Heard was invited to describe where the valuation debate stood on the other side of the North Sea. From there, the Dutch took over, presenting a variety of viewpoints on the issue at hand. By the end of the day it was clear there was broad consensus that the time had come to move the Dutch system to an 'economic valuation' philosophy, with only some of the actuaries in the room questioning the wisdom of such a move.

This *Letter* makes the case that this 'economic valuation' debate is much more than an esoteric tiff between actuaries and financial economists. Its outcome could well determine whether DB pension arrangements have a future, or whether they will go the way of the dinosaur.

A Framework to Guide the Debate

Let us begin at the beginning. Peter Drucker once wrote that every enterprise needs 'a theory of the business'. In that spirit, here is what we might say about the 'DB pension business':

DB pension schemes are in the business of reliably delivering pre-determined pension payments to its participants at minimum long term cost while maintaining stable contribution levels.

Easier said than done, of course. Yet it is a good place to begin, for this theory statement leads logically to a series of strategic questions that give it practical content. Specifically, Figure 1 over the page suggests there are 7 such questions. These questions have withstood the test of time. They first appeared in our 1986 book "Pension Funds and the Bottom Line", and re-appeared 12 years later (with Don Ezra) in "Pension Fund Excellence: Creating Value for Stakeholders". We address each question in turn.