

# The *Ambachtsheer* Letter

*Research and Commentary on Pension Governance, Finance and Investments*

Letter #194

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## **BUILDING BETTER PENSION PLANS:**

### **THE CASES OF TIAA-CREF, IWA-FOREST INDUSTRY, ONTARIO TEACHERS', AND BOOTS**

*"Economist Robert Schiller wonders why we have such faith in the utter rationality of markets when we ourselves can be kinda, you know, irrational. Bad judgement, lousy information, half-baked strategies...there are times when money brings out the worst in people. That's why Prof. Schiller's retirement dollars are invested with a company whose level-headed thinking stands out in a world where impulse and intuition are bucking intelligence and insight".*

From a TIAA-CREF advertisement  
*The Economist* magazine  
Feb. 16, 2002

#### **Game Theory and Pension Plans**

Last month's *LETTER* showed how the application of game theory can lead to constructive thinking about building better pension plans. We found that typical, supposedly win-win, 'cooperative' DB and DC pension schemes present material incentives to switch to adversarial win-lose games in certain situations. Specifically, the design weakness in both types of pension schemes is similar: too many opportunities for particular stakeholder groups to change the 'pension deal' in their favour after-the-fact, depending on how events unfold.

We noted that many DC schemes, for example, do not foster maximum use of risk pooling and risk management opportunities for plan participants. Investment diversification and age-related investment risk control are critical during the capital accumulation phase in a DC scheme. Efficient mortality risk pooling is critical during the

decumulation phase. Many DC schemes do not offer these features, or if they do, don't position or explain the features in ways that plan participants can use them to their best advantage. The potential (and increasingly actual) result is a rising number of adversarial win-lose conflicts between employers and disaffected DC plan participants with too little potential or actual retirement income.

On the DB plan playing field, we noted that switches to win-lose conflicts are usually triggered by the emergence of either material surpluses or deficits on the DB scheme balance sheet. Every stakeholder group attempts to lay claim to emerging surpluses. On the other side of the coin, every stakeholder group tries to shift the cost of emerging asset shortfalls away from them, towards the other stakeholder groups. Active employees and pensioners (often aided and abetted by legislation and the courts) usually have the upper hand in these game switches, with