

# The *Ambachtsheer* Letter

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

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## **RETHINKING FUNDING POLICY AND REGULATION: HOW SHOULD PENSION SCHEMES BE FINANCED?**

*“PGGM provides a high-quality pension scheme, with stable contributions that are kept as low as possible...”*

PGGM Annual Report, 2001

### **The Devil in the Details**

In an ideal world, all pension schemes have the attributes cited in the 2001 Annual Report of PGGM, the \$50B industry pension fund for the Dutch healthcare sector: high quality pensions financed by low, stable contribution rates. The devil, of course, is in the details. Thus in the real world, the sustainable financing of pension schemes is akin to a never-ending high-wire balancing act involving multiple stakeholder groups today and tomorrow.

The equity bull market began to blur this reality in the late 1990s, as it seemed that high quality pensions could indeed be financed with low, stable contribution rates simply by having a 60-75% asset mix weighting in equities. Indeed, in many DB schemes, it appeared that the return on the pension assets already accumulated would be sufficient to finance future benefit accruals without making any further contributions at all!

Today, with most DB balance sheet surpluses having vanished as snow in springtime, the reality of pension finance as a high-wire balancing act between multiple stakeholder groups has returned with a vengeance in countries with funded pension schemes. So, for example, Dutch pension funds are now debating new funding rules amongst themselves and with their regulator. Brit-

ish funds are trying to understand the true meaning of the new ‘minimum funding requirement’ promulgated by their government. North American DB funds and their regulators are dusting off the current regulations for solvency valuations and the potential consequences of failing the solvency test. Meanwhile, in the DC world, there is a growing gap between pension aspirations and the capital required to finance it.

Given these new realities, a *Letter* addressing the issue of how to frame pension funding policy and regulation questions seems timely. We commence by exploring the nature of the multi-stakeholder balancing act around financing pensions, and the nature of the financial and other interests that various principal and agent stakeholder groups have in pension schemes. We first apply the results of this exploration process to DC pension schemes, and then move on to the DB context. In the process, we uncover 4 guiding principles that should make the financing and regulation of DB pension schemes more transparent and effective. See if you agree.