

# The *Ambachtsheer* Letter

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

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## **FUNDING POLICY AND INVESTMENT POLICY:**

### **HOW SHOULD THEY BE INTEGRATED IN DB PENSION PLANS?**

*“Suppose an actuary had been asked for an opinion on the number of lifeboats to be deployed on the Titanic on its maiden voyage. Under current actuarial practice, the actuary first assumes that the Titanic doesn’t sink, this being the more probable outcome. Since no lifeboats are needed if the Titanic stays afloat, the actuary can make almost any lifeboat recommendation and claim that it falls within the ambit of accepted actuarial practice....”*

Malcolm Hamilton, FCIA, FSA

#### **Principles to Fund and Invest By**

Times like the present confirm the wisdom of having clearly articulated funding and investment principles and policies for DB pension plans. Without such principles and policies, the radical deterioration in plan funded status that has occurred in the last 3 years can lead to poorly conceived, knee-jerk decisions, or possibly just as bad, no decisions at all. This was the context for writing a *Letter* last October on funding policy issues for DB pension plans, followed by one in December on investment policy issues.

In the October *Letter*, we asserted that there is a shortage of clear thinking about funding policy issues, both inside the actuarial community and (not surprisingly) outside it as well. We suggested that more coherent funding policy decisions require broad adherence to three key principles by plan sponsors, actuaries, and regulators alike:

1. The ‘DB pension deal’ must be clearly articulated, including what the target pension benefit is, which stakeholder groups are to bear what risks, and who is to be accountable for the articulation and im-

plementation of the plan’s funding and investment policies over time.

2. Only ‘mark-to-market’ (ie., ‘fair value’) asset and liability values have economic meaning, and hence only such values should be used to set balance sheet funding targets, and to assess the funded status of DB plans over time.
3. Sponsors of DB plans should be required to file a ‘Statement of Funding Policy and Goals’ alongside their ‘Statement of Investment Policy and Goals’.

In the December *Letter*, we asserted that there is an equal shortage of clear thinking about pension investment policy issues, both inside the investment community and (not surprisingly) outside it as well. We suggested that more coherent investment policy decisions require broad adherence to nine key principles.