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REDESIGNING DB PENSION PLANS:

THE CASE FOR 'RISK-SHARING CO-OPERATIVES'

*“What is a DB pension plan? An extension of the employer’s balance sheet?
A captive insurance company? Or a risk-sharing co-operative?”*

Dr. Jean Frijns
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The Right Questions First

A successful search for pension plan design answers must start with the right questions. Why? Because without the right questions, there is no hope of ever arriving at the right answers. Two recent industry events offered a unique opportunity to cobble the right pension plan design questions together. As the only person on the globe to attend both events, we are now obliged to share our discoveries. We gladly do so in this *Letter*. You will see that the right design questions do indeed lead to the beginning of the right design answers.

The first of the two events, held in Toronto on May 23 and sponsored by the *Association of Canadian Pension Management (ACPM)*, was titled “Are DB Pension Plans In Crisis?” The second event took place four days later in Haarzuilen, the Netherlands. It was the annual client conference of *ABN-AMRO Mellon Global Securities Services* with its theme of “Pension Funds: A New Realm Of Possibilities”. While we contributed content to both events, the real learning came from the words of the other speakers, and from the interactions that followed. For example, co-speaker Jean

Frijns’ three pension model questions above were an important catalyst to the plan design answers sketched out below.

Risk and DB Plan Design

The first ‘take-away’ from the dual event experience was the strong conviction that risk-free pension models live only in textbooks and thought-experiments. Yet, much of the ongoing debate about pension plan design and regulations continues to be based on the implicit premise that while DC plans are risky, DB plans are not. Or at least, that DB plans should not be risky. What are the origins of this premise? A simplistic explanation might be: “If pension benefits are defined, then they must be certain”. A more sophisticated version might be: “Even though DB plan assets and liabilities are subject to volatility in the short run, everything will work out in the long run. Hence, as long as the long view is taken, there is no risk”. The experience of the 1980s and 1990s appeared to support the wisdom of this viewpoint.