

The Ambachtsheer Letter

Research and Commentary on Pension Governance, Finance and Investments

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THE PENSION REVOLUTION....ARE YOU A BELIEVER YET?

“When you possess great treasures within you, and try to tell others about them, you are seldom believed”.

Paulo Coelho, in the “The Alchemist”

“There is a body of work emerging that questions the generation-old assumptions that underlie modern investment theory.... Keith Ambachtsheer observes that the perceived ‘truth’ of the CAPM is based on three so-called ‘proofs’, but, he asks rhetorically, ‘What is wrong with these three proofs? In short, everything’.”

From the May 2003 Editorial in PLANSPONSOR magazine

“As Keith Ambachtsheer has said, investment management is becoming a risk management business. Out-performance in relative returns is no salve when traditional strategies’ absolute returns are negative, as they have been since 2000...”

From the May 26, 2003 Editorial in Pensions & Investments

“Many of the worst errors in investment management can be traced to an industry-wide focus on maverick risk. Most of us work as agents, not principals...making it more acceptable to fail conventionally, than to succeed unconventionally. Keith Ambachtsheer, using the CEM database, reports that the typical U.S. pension fund carries six times as much policy risk as active management risk relative to its liabilities. Apart from the perils of maverick risk, there is no business justification for this....”

From the May/June 2003 Editorial in the Financial Analysts Journal

A Revolutionary Reordering of the Pensions Firmament

Professional truth-sayers can identify with Paulo Coelho’s observation that their seeds of truth seem to fall largely on barren ground. It is the nature of the business. This makes concurrent citations of one’s ‘truth-saying’ work in the editorials of three major industry publications a rare ‘3-sigma’ event. In this *Letter*, we explore the meaning of this highly unusual occurrence. More importantly, we integrate the ‘truths’ of the three editorial messages into a larger whole, which adds up to nothing less than a revolutionary reordering of the pensions firmament. Are you a believer yet? Read on.

Why is such a revolutionary reordering called for? For three reasons:

1. Many ‘pension deals’ as currently defined (though often not clearly) are unsustainable.
2. The ‘business models’ that guide the management of most pension plans are built on conceptual quicksand.
3. The governance and organization design structures that implement most ‘pension deals’ are ineffective, if not downright dysfunctional.

We elaborate inside.