

The *Ambachtsheer* Letter

Research and Commentary on Pension Governance, Finance and Investments

Letter # 213

October 2003

IF DB AND DC PLANS ARE NOT THE ANSWERS, WHAT ARE THE QUESTIONS?

"It is not the answer that enlightens, but the question."

Eugene Ionesco

From Answers to Questions

We are struck by people's willingness to assume that traditional DB and DC plans are the only possible answers to the pension question, and that our only challenge is to figure out which of these two pension plan options is 'better'. What if we started with the ultimate pension questions behind the answers? Would those questions logically lead to DB or DC plans as they currently operate as the only possible answers? The message of this *Letter* is 'we think not'.

We start below by first finding the ultimate pension questions behind the traditional answers. The best answer to the first of such questions in turn leads to another question, and so on it goes. Eventually, this 'answer and question' process leads to some powerful benchmarks against which to evaluate the effectiveness of traditional DB and DC plans. The bad news is that neither of the traditional pension plan formulas scores particularly well on the resulting pension delivery effectiveness scale. The good news is that our 'answer and question' logic gives direction to the search for better pension models.

Ultimate Pension Questions and their Consequences

So what are the ultimate pension questions and answers with which to launch our quest for better answers? We think the first sequence goes something like this:

Q: "What can we do now to ensure the eventual delivery of adequate post-retirement income streams that deal effectively with default risk, multiple employer risk, inflation risk, and longevity risk?"

A: "By saving the necessary proportion of current income, and investing the proceeds in portable securities that promise default risk-free, life annuities upon retirement with payment streams tied to productivity growth and inflation".

This answer leads directly to the next ultimate 'Q&A' sequence:

Q: "Do such securities exist?"

A: "No".