

The *Ambachtsheer* Letter

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AFTER THE PERFECT PENSION STORM: WHAT NOW?

*“Friends who set forth at our side,
Falter, are lost in the storm,
We, we only, are left!”*

Matthew Arnold

From Vegas to Oxford: In Search of Answers

A recent odyssey took us to the lights of Las Vegas, the beaches of Santa Monica and then those of Zuid-Holland, a meeting room at Schiphol, and finally, the ancient splendors of Oxford University. While the locations could not have been more different, there was a common discussion theme. It was the perfect pension storm of March 2000 to March 2003, and its possible consequences.

You do remember the perfect pension storm, don't you? It was the three-year period that took the mark-to-market funded ratios of DB pension plans around the world down by 25 to 50 percentage points, depending on the plan's characteristics, location, and investment policy. How did this happen? Through extended, parallel declines in equity prices and bond yields. The former action depressed asset values, the latter pushed up the present value of future pension promises. Nor did this painful double whammy create havoc only in DB pension plans. While maybe less visible, the parallel drop in equity values and bond yields hurt the financial condition of DC plans and endowment funds too. Why? Because while asset values were falling, the cost of buying risk-free future cash-flows was going up.

Recently rising equity values and bond yields have reversed some of the financial damage caused by the perfect pension storm. Thus the financial markets have provided fund fiduciaries with some breathing room. So what to do now? Breathe a sigh of relief and carry on as before? Or is this a window of opportunity through which to ask some fundamental questions about pension 'deals', about pension delivery mechanisms, and about national pension policies? These are the questions this *Letter* addresses.