

# The *Ambachtsheer* Letter

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

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## **HUMAN FOIBLES AND AGENCY DYSFUNCTION: BUILDING PENSION PLANS FOR THE REAL WORLD**

*“Underlying this global movement towards participant choice is an implicit assumption about behavior: That the employee-citizen is a well-informed economic agent who acts rationally to maximize self-interest.”*

Olivia Mitchell and Stephen Utkus  
quoted from their book  
“Pension Design and Structure”

### **Getting the Questions Right First**

Much has been spoken and written about pension design. Discussions usually revolve around the relative merits of ‘DC vs. DB’. In other words, is it somehow better to define a contribution rate, invest the money, and see what pension it ends up buying 35 years later? Or is it better to define a target pension level 35 years hence, estimate what target contribution rate is needed to finance it, and then continue to adjust actual contributions over time until the target pension is eventually financed? Of course, anybody who knows pensions knows the answer to these questions: it depends.

Our goal in the next series of *Letters* is to take this Question & Answer approach about pension design to a much higher level. Thus we intend to go well beyond such standard DC vs. DB juxtapositioning as:

- DB helps retain key long-service employees
- DC offers employees better portability
- DB offers greater pension benefit certainty

- DC is less risky for employers
- DB can be run as a profit center by employers
- DC benefits are more tangible, and hence valued more by employees

While these are all valid observations, they don’t really go to the heart of the matter. A much more fundamental approach must start with questions such as: What should a pension arrangement attempt to accomplish? What critical considerations need to be taken into account in the design of an ideal pension arrangement? What does the resulting ideal design look like? How does this ideal design compare with the designs of today’s ‘real world’ DC and DB pension plans? What barriers stand between ‘actual’ and moving to the ‘ideal’? Can they be overcome? How?

Just as these questions go to the heart of the pension design matter, we believe that you will find the answers to them that follow do so as well.