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Book Review

Pension Fund Excellence— Creating Value for Stakeholders

by K.P. Ambachtsteere & D.D. Ezra

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Pension Fund Excellence is a handbook on "what pension funds do, how well they do it, and how they could improve their performance." The discussion is both qualitative and quantitative with the former often by-the-numbers, brimming with common sense and the latter elusive. Fund managers starting out and those who manage smaller and medium-sized funds will find this book helpful. While global in outlook, it is predominantly about trillions of dollars in U.S pension fund assets and related practices.

The concept of stakeholders is introduced as typically pension plan members and the plan sponsor, but these two groups do not always share the same objectives. Mostly, but not always, the authors sort them out. However, ERISA asks trustees (not just of U.S. corporate trends as the text states) to act in the best interests of fund participants, not stakeholders.

The topics and their treatment are interesting: the coming era of pension fund capitalism; how good is pension fund management; what fiduciaries should know; managing pension funds, asset allocation policy; some brief examples and even briefer illustrations of other countries' national pensions. Insights are plentiful and the authors do not shy away from choices. There are many notes but these occasionally refer to publications difficult to find and the authors' releases for their clients and the public. Now, for some particulars from the text.

- "All pension funds work the same way. This is summed up ... (by) ... *the fundamental pension equation:* Contributions + Investment Return = Benefits Paid." (In this equation) contributors should separate employee and employers monies; investment returns is the total of required interest and excess interest gain or loss (which affect each year's contributions); benefits should separate any expenses; starting assets are assumed to be zero as is the final terminal adjustment which could be significant (for example, on insurance company buy-outs). This is the *ultimate* cost of a pension plan and worth more discussion.
- "Pension payments are typically 80% funded by investment returns and only 20% by contributions." It would be helpful to have a source for the relationship which is referred to more than once.
- "And it is not only governing fiduciaries who want high returns but are reluctant to acknowledge that they have to accept commensurate risks of potentially bad outcomes. Even wealthy business people who otherwise would seem to be sophisticated investors behave this way." The example cited is Raul Solinas de Gortari, brother of Mexico's president from 1988 to 1994, who invested more than $80 million with Citibank. Another example should have been found.
- The authors introduce "an average risk-adjusted net value added (RAVNA)" representing "the amount of fund return left after accounting for a fund's asset mix policy, incremental operating costs, and incremental risk assumption costs." The RAVNA measure calculation is difficult to pin down. "It is a measurement system for people who would rather measure the right things imperfectly than measure the wrong things perfectly or measure nothing at all."
- There is some mention of the liability side and the work of actuaries but it is much less satisfying than the interesting discussion of the asset side. Some examples:
  - 15-year amortization payments of the unfunded liability will decrease over time.
  - Government fiduciaries should ask for a report of assets and liabilities measured using best estimates.
  - Actuaries can build a contingency reserve by using assumptions containing a margin; the "entry-age method" provides a reserve against the average-age of members increasing.

  Perhaps, with actuaries becoming more involved with the asset side, the situation will improve.
- Despite statements such as "... if one were to construct the average of everyone's asset allocation policies, most funds would be similar to this average, though most funds would also be a little bit different ..." or "... if we were to take the average holdings in any asset class, most funds would own a list of holdings in that asset class that is broadly similar to the average, though most funds would also be a little bit different from the average." The good material is of interest.

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