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PENSION INVESTMENT PLANNING

by Marty Stempel

(Editor's Note. We are indebted to Prudential's Ack-Ack and the author for permission to reprint this report.)

The Pension Section of the Actuaries Club of New York met on March 9 to discuss "Measuring Investment Performance of Pension Funds." The panel consisted of two actuaries, Bill Dreher and John Williams, and a financial consultant, Robert Augsburger. Theodore Kowalchuk was moderator.

The presentations were interesting but contained few surprises. The increasing importance of measuring the results achieved by a fund manager was indicated and hints of a growing sophistication (and its marketability) were given. Bill Dreher urged actuaries to play a greater role in this area.

The moderator opened the meeting by laying down some general principles. Using market value instead of book, accounting for unrealized gains, taking cognizance of different cash flows, objectives, constraints on the manager, and other characteristics of the funds to be compared—all met with general acceptance, in this audience at least.

"Internal Rates"

The "internal rates" for the stock and bond segments of a fund based on the actual cash flow were described as useful in the determination of interest assumptions and for comparison with the results under the hypothetical investment of similar amounts in market averages. "Time-weighted" methods may be used to compare the results under different funds. Quarterly rates of return are computed for the various funds and then linked to calculate average rates for a single input or a series of level deposits over a period of time.

The quantification of risk needs more study. Volatility, a measure of fluctuation in the rate of return, is commonly used. It is a poor indicator of risk but is calculable and may be useful in setting investment policy and ultimately the expected rate of return.

Mr. Dreher stated that the technical skill and objectivity of actuaries uniquely qualify them to assist the administrators of a plan to choose investment managers and objectives. Since meeting investment objectives is significant to the ability of the pension fund to satisfy its obligations, involvement of the actuary is part of his social responsibility. Attention to this area is also required out of concern for the continuance of the private pension field.

The actuary should assist the administrator to set a goal for investment return in relation both to market conditions and other managers. The expectation should be below the "outside limit" possible.

An objective of 110 to 115% of the general market return (2 to 3% above market, if negative) and perhaps a higher figure for a part of the fund was given as an example.

Mr. Augsburger listed other considerations in setting the expected rate of return: the level of funding the liabilities of the plan, the level of benefits and need for future improvements, effect of inflation on the plan structure. Multiple valuations based on alternative assumptions may be used to develop a range of yields necessary. He said that one fund may be found not to need as high a yield as another.

Dreher's Views

Mr. Dreher disagreed that the "need" of a fund should affect the evaluation of investment performance. According to him, capital should be fully utilized, consistent with the fiduciary responsibility of the administrators.

Other methods mentioned to measure performance of a fund manager included (1) comparing the actual portfolio rate during a period with the result for a portfolio consisting of the securities at time zero with new money put into the same securities only; (2) comparing the performance of the fund against that of other funds under the same management; (3) comparing average purchase or sales price in relation against the trend of prices for the traded securities.

Mr. Dreher remarked that the role of the actuary depends on his relationship with the client. The actuary should serve as an "organizer of information" and, with his business sense, help the client ask the right questions. But Bill wouldn't give any hot tips. Stay out of picking the portfolio, he warned.

The meeting closed with a salute to Dow-Jones. □

INTERNATIONAL STATISTICAL INSTITUTE, AUG. 10-20

by E. A. Lew and A. R. McCracken

The Society of Actuaries is one of 14 organizations sponsoring the 38th Session of the International Statistical Institute, to be held at the Shoreham Hotel in Washington, D. C., Aug. 10-20, 1971.

The scientific program will include papers and discussions from 19 countries, and while much of the program is likely to interest only the more statistically minded actuaries, there are many subjects in which the statistically ignorant actuary might be interested.

Statistical aspects of population research will be discussed, as will the measurement of population growth in the developing countries. The last will include references to recent applications of the stable population theory.

A meeting on reliability theory and the analysis of life duration will include subjects such as the early detection of disease and problems of air pollution. A discussion on the measurement of poverty in developed and developing cou tries will include special reference to India, Argentina, and the United States.

Other Subjects

Speculatively inclined investors may be interested in methods of studying by computer the "correlation of subsurface geological data." There are many other subjects surrounded with fascination and romance, such as "cluster and factor analysis in classification and correlation of paleo-environmental data."

Full privileges of participation at the 38th Session of the International Statistical Institute are by invitation only, but members of the Society of Actuaries may secure invitations by writing to H. E. Riley, Executive Secretary, 38th Session International Statistical Institute, c/o American Statistical Association, 806 15th St., N.W., Washington, D.C. 20005.

The registration fee is $40 for Canadian and United States residents who are not members of the Internation Statistical Institute. Each registrant wi. be given a full set of the invited papers and a bound volume of the contributed papers. Registration should be made before June 1. □