

# International Journal of Pension Management



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## Pension Funds, Governance and Compensation

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## About Rotman International Centre for Pension Management

The mission of the Rotman International Centre for Pension Management (Rotman ICPM) is to be a catalyst for improving the management of pensions around the world. Through its research funding and discussion forums, the Centre produces a steady stream of innovative insights into optimal pension system design and the effective management of pension delivery organizations. Using the vision of *Tomorrow's Pension Fund* as its guide, research and discussion topics focus on agency costs, governance and organization design, investment beliefs, risk measurement and management, and strategy implementation. The role of the *Journal* is to disseminate the new ideas and strategies that result from the activities of Rotman ICPM to a global audience. The Research Partners of the Centre believe that this broad dissemination is a win-win proposition for both professionals working in the global pension industry, and for its millions of beneficiaries.

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<b>Pension Funds, Governance and Compensation</b> <b>KEITH AMBACHTSHEER</b>	<b>5</b>
<b>Recasting Executive Compensation: From Gamesmanship to Authenticity</b> <i>In an excerpt from his new book <b>Fixing the Game: Real Markets, Expectations Markets, and What Capitalism Can Learn from the NFL</b>, Roger Martin argues that a single-minded focus on the expectations market will continue to drive us from crisis to crisis – unless we act now. He takes a look at executive compensation and how it should be recast to restore the health and authenticity of global capitalism.</i>	
<b>ROGER L. MARTIN</b>	<b>6</b>
<b>When Should Shareholders Say “Yes” On Pay?</b> <i>Investors all over the industrialized world are getting a say on pay. As a result, investors should seek answers to three questions which are addressed in this article. In the end, investors will also want to ensure that both the pay opportunity is not excessive and that their company has a sound governance process relating to executive compensation.</i>	
<b>AUBREY E. BOUT AND IRA T. KAY</b>	<b>12</b>
<b>How Should Pension Funds Pay Their Own People?</b> <i>Little has been written on how pension funds should pay their own people. This article draws a number of parallels between the corporate say on pay debate and the internal compensation question for pension funds. However, the article points out that there are differences too.</i>	
<b>KEITH AMBACHTSHEER</b>	<b>18</b>
<b>Pension Funds as Universal Owners: Opportunity Beckons and Leadership Calls</b> <i>Universal owners are asset owners who recognize that through their portfolios they own a slice of the whole economy and the market. They focus their actions particularly on active ownership practices and active investment strategies that integrate environmental, social and governance considerations. At the same time, they collaborate with other asset owners to produce network benefits.</i>	
<b>ROGER URWIN</b>	<b>26</b>
<b>How Green is Your Property Portfolio? The Global Real Estate Sustainability Benchmark</b> <i>This article develops a global survey for property portfolios, measuring the environmental performance of listed property companies and private property funds. This leads to an environmental scorecard – the Global Real Estate Sustainability Benchmark, which scores the current environmental performance of investors’ property portfolios, and shows the way to improving it.</i>	
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### **Why the Design of Maturing Defined Benefit Plans Needs Rethinking**

*This article explains why and how maturing defined benefit pension plans become increasingly unstable if they maintain asset mix policies that embody material mismatch risk between plan assets and liabilities. A consequence is that the design of these plans needs rethinking. The authors offer a framework for this rethinking process.*

**THEO KOCKEN**

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### **Redesigning Choice and Competition in Australian Superannuation**

*The Australian superannuation system assumed that market competition would deliver economic efficiency in its largely private defined contribution form. However, investment performance has continued to be restrained by high fees and costs. The MySuper recommendation of the Super System Review seeks to provide simpler choices and increase competition in default options for most investors.*

**WILSON SY**

**52**

### **How Should Retirees Manage Investment and Longevity Risk in a Defined Contribution World?**

*This article sets out a framework for comparing the relative risks of longevity and investment policy, and for understanding how a retiree's age and wealth (or lack of it) are important factors in how spending, investment and insurance decisions should be made. It also describes two new forms of financial products that help remove the undesirable gambling component from the traditional life annuity.*

**DON EZRA**

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## Board Effectiveness Program for Pension and Other Long-Horizon Investment Institutions

### The Program

Pension and other long-horizon investment institutions play special roles in global and national economies. There is evidence that the governing boards and managements of many of these financial institutions are struggling to keep up with the implications of the growing complexity of the investment and administration needs of their beneficiaries. Key strategic issues have emerged around organization mission, the respective roles of boards and managements, investment beliefs, the management of risk, organization design, and human resource management, including compensation.

Rotman has designed a Board Effectiveness Program to support boards of pension and other long-horizon investment institutions in clarifying their role in addressing these issues. Participants are provided with an integrated framework to critically examine how these issues are linked together, resulting in a toolkit for boards to enhance excellence and success in their institution.

#### Who Should Attend?

This intensive, highly-interactive, strategic Program is tailored specifically to those who are, or are soon to become, members of supervisory boards of long-horizon investment institutions. Participant selection criteria include qualifications, experience, and achieving group diversity. Capacity is 40 attendees.

#### Program Dates

(each Program runs 4½ days)

Offer I – November 28  
through December 2, 2011

Offer II – February 27  
through March 2, 2012

#### Program Fees

C\$6,950 plus tax

#### Application Deadline

April 15, 2011

Online application form available at  
[www.rotman.utoronto.ca/icpm](http://www.rotman.utoronto.ca/icpm)

#### For More Information:

[icpm@rotman.utoronto.ca](mailto:icpm@rotman.utoronto.ca)  
416.925.7525

### Key Takeaways

The Program enables participants to:

- Explore the unique challenges in governing pension and other long-horizon investment institutions.
- Understand fiduciary responsibilities in a 21st Century context.
- Increase transparency and clarity of roles between the board and management.
- Build and strengthen decision-making processes around investment and risk policies and their implementation.
- Guide the organization's human resources and compensation policies.
- Communicate effectively with the institution's stakeholders.

### Program Modules

#### Current Board Issues/Board Effectiveness

- Current challenges facing attendee Boards
- The theory-practice gap in governance
- Group judgment under risk

#### Guiding and Assessing Strategy

- Case studies on investment beliefs and organization design
- Investment theories and realities
- Organization design theories and realities

#### Monitoring Results

- Case study on financial disclosure
- Measuring what should be managed

#### Guiding and Assessing Human Performance

- Appointment, evaluation, compensation, and renewal of executive team
- Board selection and performance evaluation

#### Assessing Enterprise Risk

- Lessons from the Global Financial Crisis
- Case studies from the banking and pension sectors

#### Addressing Current Board Challenges

- Attendees design strategies to address challenges facing their Board
- Faculty and other attendees discuss/critique strategy presentations

*Our real world Case Studies have been used at ICPM Discussion Forums, as well as in other academic and professional forums around the world.*

## Case Studies

### Case Study #1: *PERS* and the Pension Revolution: Active Participant...or Passive Bystander?

The state's Governor felt that *Public Employees Retirement System (PERS)* needed new, vigorous leadership. He thought that private sector *turn-around* specialist Alyson Green fitted the bill perfectly. Now six weeks on the job, she had started to make serious preparations for her first Board meeting. She felt that this first meeting would offer a unique opportunity to establish a few key strategic priorities for PERS. The question is: what should those priorities be?

### Case Study #2: *PERS* and the Pension Revolution: Redesigning the Investment Function

Since Alyson Green became CEO of *PERS*, she had convinced the Governor and the leaders of the system's key stakeholder groups to change *the pension deal*. Now she has turned her attention to the investment policies of *PERS'* \$55B pension fund. The fund was being managed in a very conventional manner. The time has come to see if there wasn't a better way to design the investment function. The question is: what is the better way?

### Case Study #3: Fiduciary Management: Next Step in the Evolution of Pension Management?

There is a global movement afoot to consolidate pension management activity into large fiduciary management organizations. Opinion is divided on whether this is a good or bad idea. Join the deliberations of the Supervisory Boards of two Dutch pension plans that hold 50-50 ownership positions in a fiduciary manager named *SCALE*. The CEO of *SCALE*, Richard de Ridder, has just proposed that the organization should begin to offer its investment and administration services to other pension plans both inside and outside the Netherlands. The question is: is this a good idea?

### Case Study #4: Climate Change and Pension Funds: Risk, Opportunity, or Distraction?

Through a series of meetings with his European counterparts, Stephen Henderson, CEO of the Canadian Resources Industries Pension Plan (CRIPP) realized he was far from up-to-date on the potential impact climate change could have on CRIPP's \$75B asset portfolio. An intensive period of study persuaded Stephen and his senior colleagues that climate change could indeed be a major consideration in how CRIPP's asset portfolio should be invested. The questions are: are Stephen and his colleagues right in this judgment? If they are, how should they persuade a skeptical Board of Trustees to address this issue?

### Case Study #5: Dynamic Asset Allocation (forthcoming, October 2011)

To access ICPM Research Papers, Case Studies, Key Findings from Discussion Forums, and the Rotman International Journal of Pension Management please visit [www.rotman.utoronto.ca/icpm](http://www.rotman.utoronto.ca/icpm)



**Keith Ambachtsheer**

Director, Rotman  
International Centre  
for Pension Management,  
University of Toronto

The most direct indicator of the quality of governance in a pension or other long-horizon investment fund may be how it pays its people. Why? Because internal compensation policy offers an indication of how clearly the organization's board of governors has thought through the alignment between the organization's mission, and the resources required to achieve it. Thinking clearly about this question leads to the realization that there are only two choices from a fiduciary perspective. There is the low-cost *free rider* choice involving well-diversified passive exposures using publicly-traded securities. And there is the higher-cost *engagement* choice where the fund gets actively involved in the design and execution of value-adding strategies in both public and private markets.

The two choices have different compensation implications. Executing the free rider choice requires only a few smart people who can deal effectively with such issues as investment policy design, optimal outsourcing strategies to providers of passive investment products, and managing the fund's custodial/treasury operations. The logic of this strategy is to free ride on the higher-cost engagement strategies of others, leaving them the task of using and analyzing information for price-discovery and monitoring corporate governance quality in public markets, and negotiating advantageous deals in private markets. In the engagement strategy the fund must acquire a skilled internal investment team capable of participating successfully in active public and private markets investing. This does not mean all investing is done internally rather than externally. It does mean the team must be capable of judging which approach will be more cost-effective, and have the authority to choose between the two.

Unfortunately, the governance processes of many pension funds do not make an informed choice between the free rider and engagement strategies. Instead, they choose the *under-resource internally/pay big fees externally* option. Logic predicts this option will not produce good results for pension fund stakeholders. There is mounting evidence that this is the case. Rotman School Profs. Dyck and Pomorski recently wrote a working paper entitled "Is Bigger Better? Size and Performance in Pension Plan Management" (February 2011) which documented that the combination of scale, strategic use of passive and active strategies, and significant internal investment capabilities in private markets, make a powerful performance cocktail. These results fit nicely with those reported in an article in the Fall 2008 issue of this Journal by Ambachtsheer, Capelle, and Lum entitled "The Pension Governance Deficit: Still With Us". Funds with higher governance quality scores typically spend more on the internal oversight, management, and control functions – and generate higher abnormal returns.

Turning to the contents of this Journal, the two lead articles by Martin, and by Kay and Bout, take a fresh look at what pension and other long-horizon investment funds should say on pay in the corporate arena. Your editor then pursues the question: What should pension funds pay their own people? Urwin addresses the powerful implications of the reality that collectively, investment funds have become the owners of the means of production. Bauer, Eichholtz, Kok, and Quigley offer a compelling example of this reality in their *green real estate* article. The Journal ends with three persuasive articles by Kocken, Sy, and Ezra on the growing urgency to rethink pension plan design, and the directions that redesign should take.

*Our research funding program has produced thirteen completed Research Papers to date. They are now available at no charge to the global pensions community. ICPM is funding new research projects which will lead to additional Research Papers in future years.*

## Research Papers (listed chronologically)

- *Can Internal Swap Markets Enhance Welfare in Defined Contribution Plans?* (May 2011)  
– Jiajia Cui and Eduard Ponds
- *The Freezing of Corporate Pension Plans: Causes and Consequences* (August 2010)  
– Joshua Rauh, Irina Stefanescu, and Stephen Zeldes
- *Investment Beliefs that Matter: New Insights into the Value Drivers of Pension Funds* (July 2010)  
– Kees Koedijk, Alfred Slager, and Rob Bauer
- *Pension Fund Performance and Risk-Taking Under Decentralized Investment Management* (July 2009)  
– David Blake, Allan Timmermann, Ian Tonks, and Russ Wermers
- *Fee Disclosure to Pension Participants: Establishing Minimum Requirements* (November 2008)  
– John A. Turner and Hazel Witte
- *The Canada Supplementary Pension Plan (CSPP): Towards an Adequate, Affordable Pension for All Canadians* (May 2008) – Keith Ambachtsheer
- *Optimal Decentralized ALM* (May 2008) – Jules van Binsbergen, Michael Brandt, and Ralph Koijen
- *Board of Trustee Composition and Investment Performance of US Public Pension Plans* (February 2008)  
– Joel Harper
- *International Diversification and Labor Income Risk* (October 2007) – Carolina Fugazza, Maela Giofré, and Giovanna Nicodano
- *Pension Reform, Ownership Structure and Corporate Governance: Evidence from Sweden* (September 2007)  
– Mariassunta Giannetti and Luc Laeven
- *Identifying and Mobilizing Win-Win Opportunities for Collaboration Among Pension Fund Institutions and their Agents* (July 2007) – Danyelle Guyatt
- *The State of Global Pension Fund Governance Today: Board Competency Still a Problem* (June 2007)  
– Keith Ambachtsheer, Ronald Capelle, and Hubert Lum
- *The Performance of US Pension Funds: New Insights into the Agency Costs Debate* (April 2007) – Rob Bauer, Rik Frehen, Hubert Lum, and Roger Otten

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## Our Research Partners

Rotman ICPM's goal is to work with approximately thirty thought-leading Research Partners from around the globe on a long-term basis. Each Research Partner makes a financial commitment of C\$25,000 to support pension research, to communicate its findings through the *Rotman International Journal of Pension Management*, and to fund the organization and execution of the Discussion Forums and Executive Education Programs. These commitments are renewed annually at the option of each organization. New Research Partners may be approved at the discretion of the ICPM Board of Directors.

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## 2011 / 2012 ICPM Research Partners

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World Bank

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Australian Prudential Regulation Authority  
Australian Super  
SunSuper  
UniSuper

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Alberta Local Authorities Pension Plan  
Caisse de dépôt et placement du Québec  
Canada Pension Plan Investment Board  
Healthcare of Ontario Pension Plan  
Ontario Municipal Employees Retirement System  
Ontario Teachers' Pension Plan

### Denmark

Danish Labour Market Supplementary Pension (ATP)

### Finland

Finland State Pension Fund

### Japan

Nomura Research Institute

### Netherlands

Algemene Pensioen Groep (APG)  
De Nederlandsche Bank  
PGGM  
Stichting Philips Pensioenfonds  
Syntrus Achmea Asset Management

### New Zealand

New Zealand Superannuation Fund

### United Kingdom

British Telecom Pension Scheme  
National Employment Savings Trust  
Universities Superannuation Scheme

### United States

California Public Employees' Retirement System  
California State Teachers' Retirement System  
TIAA-CREF  
Washington State Investment Board



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