

Can the Pensions Sector Innovate?

By the standards of such sectors as information technology, the pensions sector has been a global innovation laggard. This issue of the Journal provides evidence this may finally be changing.

KEITH AMBACHTSHEER

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Benchmarking Retirement Income Systems around the World: Which Countries Rank Highest and Why?

The Melbourne Mercer Global Pension Index considers more than 40 indicators in calculating an Index value for the systems in 16 countries covering more than half the world's population. Index values indicate considerable global variance in pension system adequacy, sustainability, and integrity.

DAVID KNOX

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Pension Liability Measurement and Intergenerational Fairness: Two Case Studies

The liability valuation techniques of state and local pension plans in the United States and those recently proposed in the Netherlands are two examples of how current practices underestimate pension liabilities. This leads to intergenerational wealth-distribution effects that can be deeply damaging.

THEO KOCKEN

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Incorporating Uncertainty into Accounting Estimates of Pension Liabilities

A model for obtaining estimates of pension shortfalls when rates of return are uncertain shows that the risks of underfunding are much greater than indicated in current financial reporting. Current practices must be changed to address this problem.

ULRICH MENZEFRICKE and WALLY SMIELIAUSKAS

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How Large Pension Funds Organize Themselves: Findings from a Unique 19-Fund Survey

A key finding was that more internal management is associated with greater fund size, lower operating costs, and higher net returns. Also, investment staff compensation varies widely, and Board selection processes continue to limit Board diversity.

JODY MACINTOSH and TOM SCHEIBELHUT

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The Road Ahead: Rethinking the Investment Policy Roadmap

Taxpayers, pensioners and political and union leadership should regard innovation in the investment and governance practices as important as changes in liability measurement and disclosure. This article describes New York City's efforts to ameliorate investment and governance shortcomings.

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Really Investing for the Long-Term: A Case Study

PGGM Investment Management has created a dedicated equity portfolio with a long-horizon investment mandate. Its management integrates financial, environmental, social and governance factors with active ownership on an ongoing basis.

ALEX VAN DER VELDEN and OTTO VAN BUUL

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Thinking Strategically about Climate Change: Risks and Opportunities

This article describes a large-scale research project analyzing the potential impact of climate change on investors' portfolios. Using four climate change scenarios to measure sources of investment risk leads to the conclusion that risks and uncertainty around climate policy can account for 10% of total fund risk.

DANYELLE GUYATT, JANE AMBACHTSHEER and ELISABETH BOURQUI

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The BP Crisis as a "Preventable Surprise": Lessons for Institutional Investors

The authors argue that BP's Gulf of Mexico spill was an instructive example of a 'preventable surprise'. They further argue for the adoption of fundamentally different mindsets by pension fund fiduciaries that focus on acquiring and nurturing sustainable cash-flows rather than short-term capital gains.

RAJ THAMOTHERAM and MAXIME LE FLOC'H

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ICPM RESEARCH PROJECT UPDATE

ICPM Invests in Innovation

ICPM believes there is a strong link between research and innovation. The Research Committee has just finished selecting four research projects for funding from 34 original proposals. The projects are in the areas of pension design, risk tolerance and liability valuation.

STEFAN LUNDBERGH

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Keith Ambachtsheer

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

The innovation track record of the pensions sector is not inspiring. A good example is the common retirement age of 65, established more than a century ago in most of the developed world: despite dramatic improvements in health and longevity, and equally dramatic declines in birth rates, only recently have we begun to deal with the logical consequences – longer working lives and greater flexibility in the transition from work to retirement. This new flexibility in thinking about the meaning of retirement is not the only evidence that the tradition-bound pensions sector is finally beginning to innovate. This issue of the *Journal* is replete with new ideas on how the pensions sector can better serve the retirement financing needs of its clients.

David Knox leads off with an update of the Melbourne Mercer Global Pension Index (MMGPI) project. In keeping with the dictate that “what gets measured gets managed,” MMGPI ranks the quality of country-wide retirement income systems based on adequacy of pension incomes, sustainability of the system, and integrity. Much can be learned from understanding how the MMGPI is constructed and why some countries are achieving higher scores than others. Articles by Theo Kocken and by Ulrich Menzefricke and Wally Smieliauskas remind us of the importance of clear purpose and theoretical rigor in the disclosure of pension plans’ financial status. Information that lacks these attributes can lead to unfair intergenerational wealth transfers and to material understatement of balance-sheet mismatch risk.

Jody MacIntosh and Tom Scheibelhut describe the findings from a unique 19-fund benchmarking survey on how large funds organize themselves, and how organization structure can impact performance. Ranji Nagaswami argues for a fundamental rethinking of how pension funds make investment decisions: not only the sources of risk and return, but also the decision-making processes that convert risk and return expectations into portfolio actions, need rethinking. Ultimately, all this is about mission clarity for pension fund organizations and governance structures capable of turning aspiration into reality. A key investment success element is time horizon. As Keynes put it many years ago, active management has to transition from short-horizon *beauty contest* investing, which is a zero-sum game, to long-horizon investing that creates wealth. Alex van der Velden and Otto van Buul describe the practical implications of such an investment-horizon shift in the management of a \$4B equity portfolio.

Articles by Danyelle Guyatt, Jane Ambachtsheer and Elisabeth Bourqui as well as by Raj Thamotheram and Maxime Le Floc’h offer new perspectives on the risk-management side of pensions. The former describes a project that integrates the risks (and opportunities) associated with climate change into the investment of retirement savings; a key finding is that uncertainties surrounding climate change and the policy responses (or non-responses) to it can account for as much as 10% of total fund risk. The latter argues that pension funds typically face an array of *preventable surprises* that are worth understanding and responding to before they become reality. The BP crisis is an example; the authors list several indicators that made the BP crisis plausible, and hence preventable, before it led to environmental and financial disaster. A clearer, more relevant understanding of twenty-first-century fiduciary duties would trigger a positive change in risk-management policies and procedures.

The issue ends with brief descriptions by ICPM Research Committee Chair Stefan Lundbergh of the four research proposals that have just received ICPM funding. The Centre and its 34 Research Partners recognize that research and innovation go hand in hand – research today is the fuel that will propel pension-sector innovation tomorrow.

About Rotman International Centre for Pension Management

The mission of the Rotman International Centre for Pension Management (Rotman ICPM) is to be an internationally-recognized, high-impact catalyst for fostering effective pension design and management. Its four primary tools to achieve this goal are the funding of objective and transformative research, the organization of interactive, action-oriented discussion forums, the publication of a readable journal relevant to professionals in the pensions and related fields, and the delivery of the globe's leading governance education program for Board members of pension other long-horizon investment institutions.

Publisher and Editor

Keith Ambachtsheer

Associate Publisher and Editor

Ann Henhoeffter

Copy Editor

Sylvia Hunter

Design

watermarkdesign.ca



151 Bloor Street West, Suite 702
Toronto, Ontario Canada M5S 1S4
Tel: 416.925.4153
Fax: 416.925.7377
icpm@rotman.utoronto.ca
www.rotman.utoronto.ca/icpm



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