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Pensions focus 'must shift to liability benchmarking'

NETHERLANDS – One impact of the credit crisis on pension funds is the growing importance of risk management and a focus on moving towards using scheme liabilities as the ultimate benchmark, according

Van Stuijvenberg, one of the nine nominees for the Outstanding Industry Contribution Award at the IPE European Pension Fund Awards in Dublin this evening, told IPE there is more research into matching pension liabilities in the Dutch market, with "more parties thinking that as soon as interest rates normalise a bit they will cover an additional part of their liabilities".

He pointed out that pension funds which have had a strong focus on liability management, rather than focusing on absolute return-based total fund benchmarks, "had a lower decrease in their solvency ratio". So going forward, he argued "the true liabilities represented by an investable liabilities benchmark will become the sole benchmark for pension funds. This will create the right incentive structure both return and risk wise," said van Stuijvenberg.

In an interview with *IPE,* van Stuijvenberg, who runs his own financial services consultancy, noted that over the last year there has been a "further realisation of the need for risk management in the asset versus liabilities space. There was also an increased interest in passive management of liquid sub asset classes."

He suggested that through "plain vanilla equity and fixed income products", pension funds are focusing on less active and more passive management and then transferring the active risk to alternative asset classes so they are spending the active management in less liquid and less transparent investments where gain of true alpha is more likely.

"This is a good and interesting development because the risk is spent more efficiently, in areas where the possibility of alpha is bigger," said van Stuijvenberg. "A severe part of the reduction in solvency came from falling equity prices and other risk-bearing assets. On top of this, the solvency problem was generated because liabilities increased, which could have been prevented by having a significant duration overlay in place."

He argued pension funds should make their liabilities the sole benchmark, which will reduce volatility in solvency ratios, adding this does not necessarily mean funds would not hold equities anymore.

"It will result in only taking risks that in the asset versus liabilities space adds value," said van Stuijvenberg. "They will go for the highest return per unit of tracking error versus the liabilities.

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“If you change the target, the game will change and the end result will be more stable solvency. We have already built liability benchmarks for schemes but they are more of a secondary benchmark. The next step will be to make it the true benchmark. Some pension funds are doing something very close to this, so in the next five years 30-50% of schemes could have liabilities as their only benchmark,” he continued.

Van Stuijvenberg meanwhile also suggested that growth in the fiduciary management market could be “coming to an end as people are a bit disappointed in the results”. He said he is seeing a “movement away from fiduciary management to multi-manager type arrangements” which could offer a big chance for consultants to step into the space.

“It is a nice change that fiduciary management is going back, with consultants doing more and pension funds taking on more internal people. It goes back to a triangle between the scheme, consultants and asset managers and offers a clearer structure.”

He argued that “from the beginning it has been overrated. It is an interesting thing to do but people overestimated what they could get out of it. The catalyst for the disappointment was the fact that the markets went down”.

“It is a good time for implemented consulting or something like 'fiduciary light'. Fiduciary management has been proven to be one step too far, so it is a good time to explore other options. This could be going to a different fiduciary manager, stepping back to implemented consulting or a more limited version of fiduciary. Or it could be taking an approach similar to PME, before they joined Mn Services, which outsourced as much as it could but kept major tasks such as asset allocation internal.”

If you have any comments you would like to add to this or any other story, contact Nyree Stewart on + 44 (0)20 7261 4618 or email nyree.stewart@ipe.com

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