

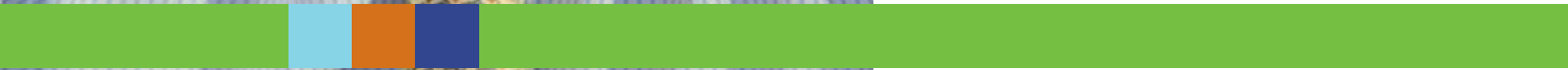


Do we need to know the day-b

This spring the coverage ratios of major pension funds were between 80 and 90%, while mid-2007 they were fluctuating at around 145% on average. This represents a reduction of almost half - and the blow was hard. As administrators we naturally expected that 2008 would be a bad year. The returns from 2003 through 2007 had been very high. The growth of our managed assets was actually higher than the annual growth of the Dutch economy. This was not really sustainable. But we did not expect such a fast decline. Particularly when Lehman Brothers went under, everything went downhill very quickly. When something like this happens it is difficult for large pension funds to make quick, radical changes to their investment portfolio. You're talking about hundreds of billions of euros. Managing assets on this scale is comparable with steering a giant tanker.

One-quarter of the drop in coverage ratios was caused by a reduction of assets. Three-quarters was due to lower interest rates. This makes it mainly an accounting issue. When people hear about 'the coverage ratio' they think it's set in stone. But first you

APG boss Dick Sluimers unimpressed



Dick Sluimers is chairman at the Dutch pension fund services provider APG. Managing assets of €230 billion for various pension funds, APG is an important player in the pensions world. In this article, Sluimers outlines his view that it is time to get away from the daily determination of the coverage ratio – a constant focus of attention for the media, politicians and regulators. While he admits that it's interesting to know the day-to-day value of a pension fund, he asks: "But what is the relevance?"

must take a good look at how a coverage ratio is established. The coverage ratio is calculated based on a risk-free return – as if the investment were entirely in bonds with a return of 3.8%. You then get a coverage ratio that you always achieve. But if you invest slightly more in equities and earn more than 3.8%, the coverage ratio quickly rises again. In that sense it's a kind of minimum coverage ratio. There's nothing wrong with choosing to sit at the bottom end for safety's sake, just as long as you realize that it is the bottom end. The difficulty, however, is that the coverage ratio is very sensitive to interest rates. In December 2008, for example, we saw interest rates fluctuate by more than 100 basis points within just a few days. When this occurs a large pension fund may find itself 10 to 20 billion euros worse off on one day and richer again the next day. While this might be true in accounting terms, in reality it's obviously not the case. In the long term this is what it's all about. It's the reason for our proposal to take a seven-year average for the interest rate. You then encounter all good and bad years and keep the outcomes far more limited. While it might be very interesting to calculate the coverage ratio at the day value, the worth of such a calculation for pension funds that invest over a term of dozens of years is relative. Pension funds and administrators are like marathon runners. The runners don't look at their watches every five minutes. They look every five kilometers. It's something that we shouldn't do either. Otherwise pension funds will adopt a very wrong approach to their investment policy.

It doesn't work like that

We need to watch out that the crisis doesn't make us want to do business and make investments only if there are no risks

attached. If that happens I have some very bad news: it doesn't work like that. If you are willing to pay roughly 20% of your income as a pension premium, it's fairly simple to work out that the pension fund will have to get a return of about 6.5% to be able to fulfill its commitments in due course. If the fund were to invest everything in fixed-interest securities and thus get a return of 3.8%, it works out to a premium of about 30 to 35%. This is not an opinion, but a mathematical reality. If you continue to hedge everything structurally, the premium will automatically increase. The lower the premium percentage, the more risk the pension funds will have to take.

Should funds start to hedge on a large scale? I can well imagine that a fund would not do so at the present time. An awful lot of money has been pumped into the economy, so the central banks will soon have to apply the brakes to prevent inflation from starting to rise too much. The question is whether this will actually happen through interest-rate increases and whether the budding recovery will slow down again. It's a tricky question

“You can embed everything, but ultimately you are dependent upon the person in America who decides for us whether or not to enter asset-backed securities.”

I believe that for the cultural balance in your company it's wise to have more women at the top of the company. Research into the Deal or No Deal program revealed that women take home twice as much from the game as men do. Women are far more likely to stop on time. If you see young men with friends in the audience,

sed by calculating coverage ratios using the day value

Day-day value of pension funds?

politically and we saw it happen after the Internet bubble. So money remains cheap, you get a renewed flood of leveraged products and bang, there we go again. One thing is always evident: it happens time and again. And through knowledge, skill and technology the effects become bigger and bigger.

Culture is the greatest risk

Risk models, regulators, risk management - they are all important and necessary. But they are not enough. It's only enough when the person who must take the decisions is calm and wise, a person who does not dream the entire day of the big hit that he wants to make. We are long-term investors. We agree long-term arrangements with our people. We keep a watch on ratios. There is no question with us of getting 10 or 20 times your fixed salary as a bonus. If you allow that, you create the wrong culture in your organization. People no longer do what they should be doing. A wrong culture is the biggest risk of all. Ultimately, it's about the people who are in charge of the company. How are they placed? How are their offices furnished? How do they act within the company? What behavior is appreciated - and what isn't?

You can build enormous systems, but people can always get round systems. That's why it's so important that people accept that there are certain rules and that there are certain risks that you must not take. It will always be people's work. You can embed everything, but ultimately you are dependent upon the person in America who decides for us whether or not to enter asset-backed securities. Culture is not something you find in models, it's within the walls.

you know that it's going to be all or nothing. It usually turns out to be nothing. Women do not listen to their husbands in the audience who urge them to take more risks, they phone their mother instead. Nine times out of 10 the mother asks: 'How much do you already have? That much! Stop!' Fortunately, women are currently the asset managers at the two largest pension funds in the Netherlands. <

[WWW.APG.NL](http://www.apg.nl)

About APG and Dick Sluimers

APG (Algemene Pensioengroep) administers collective pension schemes for members working in the education, government, construction, cleaning and window cleaning sectors and at housing corporations, energy companies and public utilities. For these sectors APG manages pension assets amounting to approximately €205 billion (at 30 June 2009). APG works for more than 20,000 employers and provides income to more than 4 million members. In the Netherlands, APG manages more than 30% of all collective pension plans.

Board chairman Dick Sluimers (1953) studied economics at the Erasmus University in Rotterdam and political science at the University of Amsterdam. Before joining ABP in 1997 and subsequently APG, he was the Director-General of the State Budget at the Ministry of Finance.