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Pension Fund Governance Issues in Today's World:

What Lessons have we Learned?
A Pension Fund Perspective

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What means Governance?

The word *governance* derives from the Greek verb κυβερνάω [*kubernáo*] which means *to steer* (*Wikipedia*).

In order to steer you must know

- Where you are / Where you want to go
- What options you have (where the wind comes from)
- Where the risks / opportunities are





Current Understanding of Governance?

- Strongly influenced by Enron & Worldcom scandals and the Sarbanes/Oxley act
 - In Switzerland also by Swissfirst, Gemini, Rieter, etc.
- ⇒ Too much concentrated on independence, control and integrity
- ⇒ Required but not sufficient !
- ⇒ Does not really address issues in current, difficult environment !

Example: ASIP Charta

■ Fiduciary Duties

- Loyalty, protecting interests of stakeholders
- Diligence, documenting decision process
- True, adequate and regular communication

■ Integrity => No personal benefits

- No gifts or kick-backs
- No conflicting own investments (front-running etc.)

■ Potential Conflicts of interest

- Disclose and if required mitigate

What is Missing?

- Guidance regarding trade-off's
 - Short-term risk versus long-term yield
 - Interest of active members versus interest of retirees
- Impartiality between various stakeholders
- Dealing with conflicting goals
 - Poor coverage ratio requires to lower risk and reduce equities
 - Recovery requires to increase risk and equities

Importance of Governance

- Strong governance brings superior performance (1-2%)
- Reasons
 - Effective risk management
 - Effective performance monitoring
 - Presence of a CIO
 - Linking investment strategy to governance capability of board

Empirical Evidence for Weaknesses

■ Main:

- Poor selection process for board members
- Lack of self-evaluation of effectiveness
- Weak oversight

■ Minor:

- Lack of delegation clarity between board and management
- Micro-management by board
- Non-competitive compensation policies



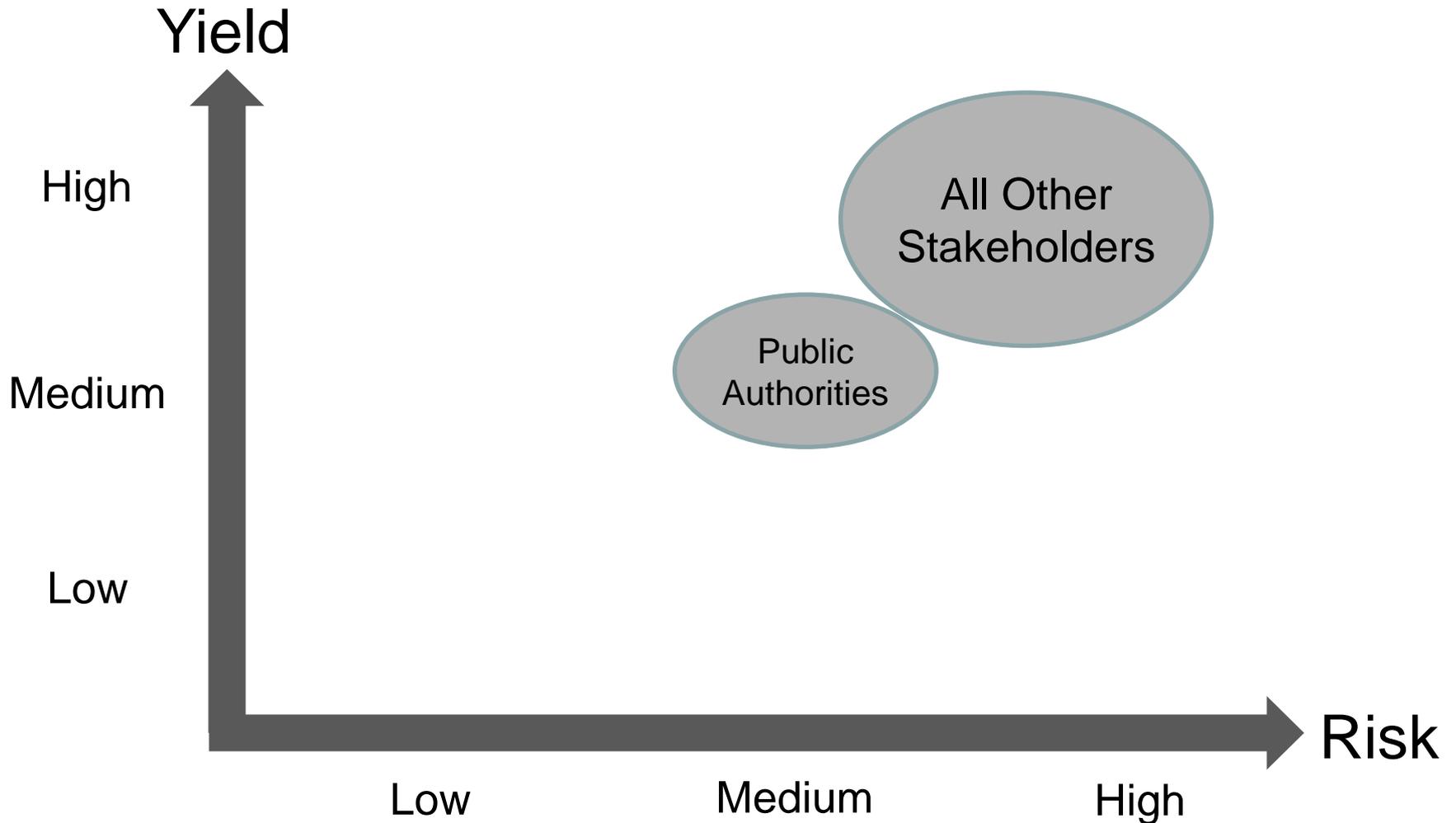
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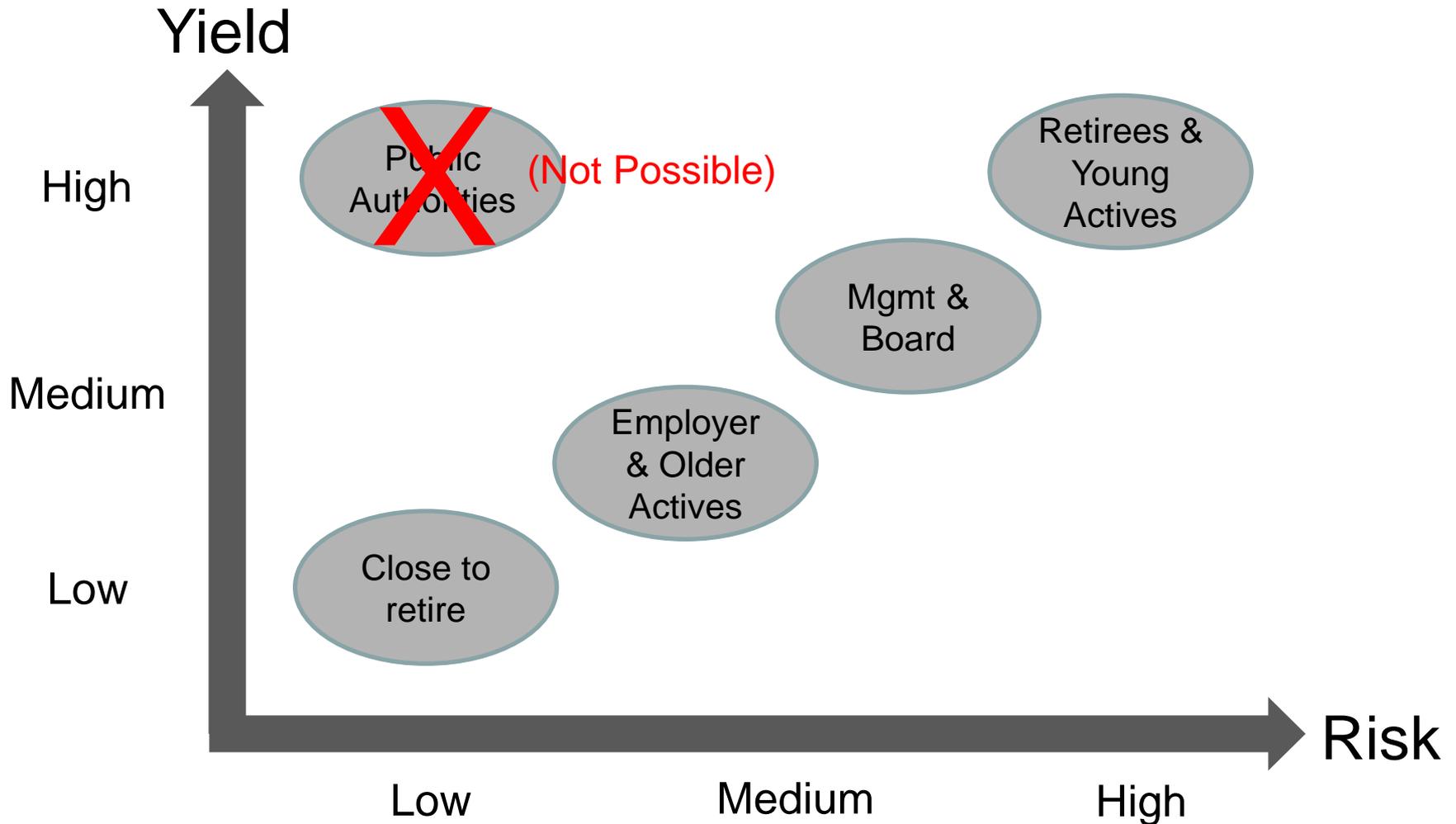
Who are the Stakeholders?

- Young active participants
- Older active participants
- Participants who will retire in < 5 years
- Retirees
- Employer
- Management of Pension Fund
- Board of Pension Fund
- Public Authorities

Interests of Stakeholders (In Low Risk Environment)



Interests of Stakeholders (In High Risk Environment)



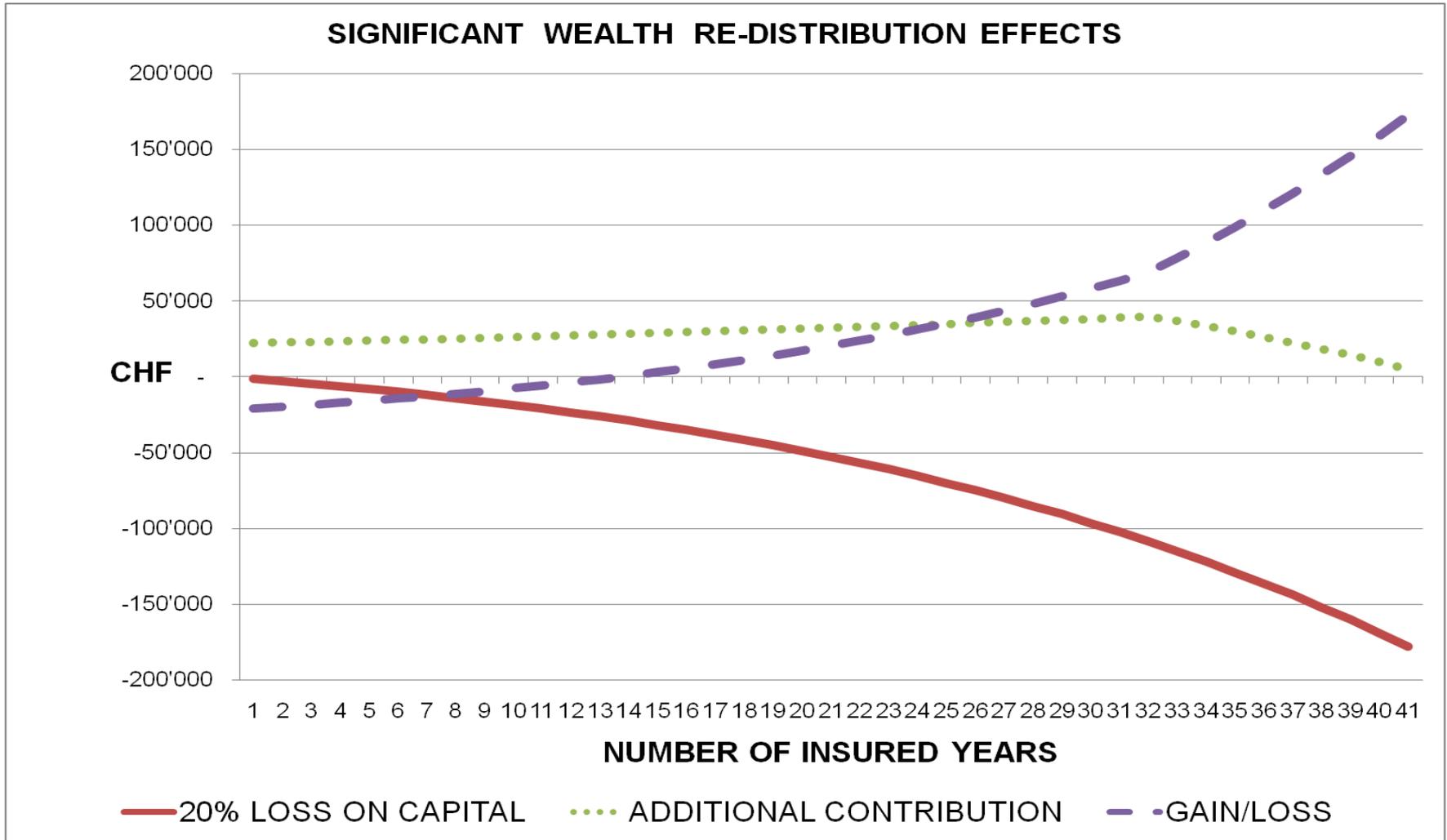


Conclusions

- Stakeholders have different risk/return profiles and incentives
- Risk/Return profiles likely depend on coverage ratio and perceived market risk
- Board and management of fund have challenging task to govern (steer) in environment with moving targets
- “Buy and hold” is not good enough



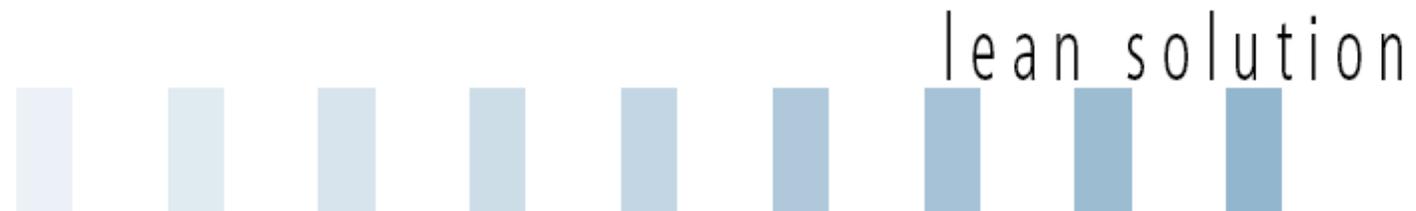
Cost of Financial Recovery





Other Lessons Learned

- All valuations depend on risk premium
- All asset values are correlated if risk premium or risk perception shifts
- We have to
 - care about the small print in the contracts with service providers
 - Question potential conflicts of interest due to related parties transactions
 - Understand incentive structure as incentives may drive strange behavior



lean solution

simple, effective and sustainable

Urs Fischer

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