PENSION FUND INDUSTRY

Fall 2002

Size in 1990:

All Assets:	13.7 Trillion
Institutions:	6.1 Trillion
Pension Funds:	2.2 Trillion

a. 80% defined benefit
b. 20% defined contribution

Defined Contribution:

(1) Each investor has a separate account.

(2) Value depends on contribution and appreciation, and pension depends on value of account at retirement.

(3) Investor chooses allocation.

(4) Usually a menu of choices.

(5) Employer defines menu.

Defined Benefit:

(1). One pool for all investors.

(2). Benefit related to salary.

(3). Corporation allocates assets.

(4). Corporation has a residual liability – pension fund is a senior claimant.

(5). PBC has final residual liability.

Some Structural Decisions for Defined Benefit

- Internal or external manager.

- Passive or active.

- Proportion in any asset category.

Some Comments

- Major decisions aggregate asset allocation and which manager.

- Decision made by management committee.

Financial Intermediaries

Key Characteristics of Financial Intermediaries:

(1). Leverage

(2). Assets & liabilities are both financial instruments.

Leverage example – typical insurance company balance sheet:

Assets:	**41B**	**Liability:**	**40B**
		Net Worth:	**1B**

Implication – mostly bonds.

Major Asset Classes:

(1). Common Equity

(2). Bonds

(3). Real Estate

(4). Commodity and Financial Futures

(5). Domestic and International

(6). Privately and publicly traded