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Pension Fund Management. A Case Study

1. Introduction

In 1927, AT&T funded the first big corporate retirement plan, but it was much later that the large-scale pension fund business saw the day. Between this first step of the late 1920s and in the last four decades of the twentieth century came the government-sponsored national pension-and-health plans, of which the French Social Security of 1936 is one of the first holistic examples. Whether private or public, pension plans are a social safety net and their financing takes one of two forms:

- **Pay-as-you-go**, typically the national pension plan’s solution, and
- **Reserves**, with the money pouring into the pension plan’s coffers used for investments.

Because of their function as savings vehicles for old age, pension funds (as well as life insurance companies) should primarily invest in the safer financial assets of a longer-term nature, with bonds given preference over stocks because equities have higher volatility. This choice, however, is not the general case. According to European Central Bank (ECB) statistics, at the end of 2002,

- holdings of debt securities constituted 38 percent, and
- quoted shares constituted 35 percent of total financial assets of insurance firms and pension funds in euroland.

Although the overall share of securities in the total assets of euroland’s pension funds and insurance firms remained largely unchanged at around 70 percent to 75 percent over the past five years, significant changes have occurred with respect to the importance of quoted shares relative to debt securities. Based on statistics from the European Central Bank, Figure 3.1 shows a late 2002 distribution of assets.
During the stock-market boom of the late 1990s, the value of share holdings rocketed. By the end of 2000, the average European ratio of quoted shares to total assets peaked at 41 percent. Correspondingly, bonds constituted only 33 percent of total assets. The subsequent stock-market crash, in 2000 to 2003, reversed these ratios, causing the combined value of quoted shares and mutual fund shares on the pension funds’ aggregated balance sheet to decrease notably. With this, by the end of 2002 the share of debt securities returned to its end-1998 level.¹

In America, life insurance companies and other entities offering annuities have been investing in long-term debt securities much more than in quoted fund shares, in line with their long-term investment horizon. Pension funds, however, particularly those sponsored by companies, have followed the opposite investment strategy – being overexposed in the company’s own shares.

Behind this lopsided distribution has been a conflict of interest. According to a late 2002 study by Crédit Suisse First Boston, about 69 percent of 2001 corporate profits in the United States were derived by manipulating the company’s pension fund earnings. If actual pension fund gains or losses on investments in the stock market, rather than inflated estimated gains, were taken as the basis of profit and loss (P&L), overall earnings for the S&P 500 would have been $68.7 billion rather than $219 billion, and this $68.7 billion is just over 31 percent of what companies reported for 2001.²

A different way of reading these statistics is that some $150 billion in corporate profit did not really exist. It was invented. Ironically, this

![Figure 3.1](image-url)  
**Figure 3.1** Financial investment of pension funds and insurance companies in euroland, 2002, Q3  
**Source:** Statistics from European Central Bank.