

21st Century Risks & Rewards for Actuaries
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SYNOPSIS

Evaluation Criteria for Pension System and its application to Pension Reform in Japan

Mirko Cardinale

This paper explores the long-term relationship between salaries and asset prices and relates it to asset allocation decisions of defined benefit pension funds. In particular, it discusses whether a 100% bond allocation is indeed the minimum risk position for an ongoing scheme whose benefits accruing to active members rise in line with their wages. The main finding is that, while shorter-run correlation evidence is less consistent, there is indeed a long-run link between the evolution of salary-linked liabilities and a range of asset classes including equities. This long-run positive linkage is consistent with economic theory. The implications for effective practice in minimum risk asset allocation depend on portfolio rebalancing costs, how much short and medium-run asset allocations move around the long-term equilibrium as well as how significant active liabilities are as a proportion of total pension liabilities.