# Alternative factors driving pension fund investments

# Alternative Factors Driving Pension Fund Investments

by
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## Summary

The governance of a pension fund is quite complex because of the large number of stakeholders that are involved. A board of trustees makes key investment decisions on behalf of an heterogenous group of plan's beneficiaries. External advisors and asset management firms are hired to assists trustees. In my dissertation, I study how this complexity affects the asset allocation of pension funds. Specifically, I show that trustees characteristics such as age, gender and representation affect their investment decisions. In theory, trustees should only consider beneficiaries characteristics when investing pension funds' money. Moreover, I show that external advisors can transfer their investment beliefs to the pension funds that they work for. These beliefs can overrule pension fund characteristics. Consequently, pension funds with the same advisor invest similarly. Furthermore, I show that pension fund asset managers tend to buy and sell the same stocks that other asset managers have bought and sold. This behaviour negatively impacts their performance. The main findings of each of three chapter can be summarized as follows:

1. Higher average board age lowers the strategic allocation to equity by 7 percentage points after controlling for a pension fund's characteristics. In addition, pension funds with a greater representation of employers on the board allocate more to equities.

2. Pension funds make similar asset allocation decisions in the presence of a common asset manager or a common actuary, despite significant differences in their liability structures, funding levels, or sizes. This effect is particularly strong in private equity, hedge funds, and commodities.

3. Pension funds follow each other into and out of the same stocks (i.e., they herd) over time. Pension funds that herd underperform pension funds that do not herd by 1.32% on an annual basis. Small pension funds and pension funds that trade less frequently are more likely to herd. These pension funds herd consistently over time. Hence, they appear to make this decision strategically out of reputational concerns.

The results of my dissertation are relevant for pension fund governance and can be addressed by the regulator too. Moreover, they have implications for financial stability. Dutch pension funds still have room to improve in terms of both age and gender diversity of their boards. The findings of the thesis also call for stronger monitoring of external advisors by the board of trustees to mitigate the potential misalignment of incentives. Furthermore, trustees should require sufficient transparency from the asset management firms on their process of selecting securities. Trustees should also assess if the security selection reflects to a large extent the investment beliefs of a pension fund.

Because of the common-advisor effect or herding, pension funds might develop portfolios that become increasingly exposed to common risk factors over time. Especially if pension funds develop similar strategic asset allocation or apply similar interest rate hedging strategies. Consequently, the probability of pension funds going into distress at the same time can increase. In fact, if all pension funds hold a similarly diversified portfolio, a common idiosyncratic shock may disrupt all the pension funds simultaneously.