➔ Press release ABP, fourth quarter 2008

Main points

- Coverage ratio 90% at the end of 2008
- Falling interest rate major cause of decreased coverage ratio
- ABP working on recovery plan

Heerlen, 29 January 2009 – Since the end of the third quarter of 2008, the coverage ratio of Stichting pensioenfonds ABP dropped from 118% to 90%. This drop was mainly due to the falling interest rate (two-thirds) and in part by the decrease of the fund assets (one third). Over the last two months of 2008, the falling interest rate was almost entirely responsible for the decreased coverage ratio. A return on investments of -11.5 % was recorded for the fourth quarter of 2008 as a whole. The biggest loss was incurred in October. ABP’s assets therefore currently amount to €173 billion. The payment of the pensions is not in danger.

In the last two months of 2008 in particular, the falling interest rate was almost entirely responsible for the decreasing coverage ratio of the pension fund. The long-term interest rate dropped to a historic low of 3.6% towards the end of 2008. A falling interest rate results in an increasing value of the pension liabilities. And this, coupled with the loss on the investment portfolio, more specifically in October – as a result of the persistent turbulence on the financial markets worldwide – has resulted in the aforementioned deterioration of the financial position of the pension fund.

As ABP's coverage ratio is lower than 105%, there is a situation of underfunding. ABP is therefore obliged to submit a recovery plan to De Nederlandsche Bank by 31 March at the latest. The aim of this plan is to ensure that, in accordance with the requirements of the current regulatory framework, the fund has eliminated the situation of underfunding within 3 years and that the value of the assets is on the level specified by the Pensions Act within a period of 15 years. ABP will continue to work on the basis of its long-term investment approach for this recovery plan.

Chairman of the Board of ABP Elco Brinkman talks of an exceptional development in the last few months of 2008: “Just like other pension funds, ABP has suffered greatly from the consequences of the financial crisis. This crisis, which evolved very rapidly in the last few months of 2008, is the worst ever in ABP's history. In the last quarter of 2008, the fund lost approximately €22 billion of the almost €80 billion ABP had made with investments after the dot-com crisis between 2003 and 2008. Our focus over the coming months will be on recovering the fund's financial position.”

In December 2008, the ABP Board decided that as per 1 January 2009, it will not be possible to allow pensions to increase with the average development of wages. The Board also decided, in view of the unstable financial markets and the economic circumstances, to see whether a new indexation decision is warranted before 1 July 2009 following the approved recovery plan.

Developments in the fourth quarter of 2008

Over the fourth quarter, the coverage ratio fell from 118% to 90%. This decline was largely due to a sharp interest rate drop in the fourth quarter. After a drop from 4.9% to 4.5% in the first nine months of the year, the interest rate in the last three months fell by almost a whole percentage point to 3.6%. According to regular calculation rules, the liabilities therefore increased more than 16%, from €166 billion to €193 billion. The drop in capital from €195 billion to €173 billion occurred chiefly in the turbulent month of October. Over the last two months of 2008, the losses on the investment portfolio were relatively small.

Over the fourth quarter of 2008, ABP's investment portfolio made a return of -11.5%. The negative return over the fourth quarter of 2008 was partly caused by the return on equities and alternative investments (-23.0%). As a result of the credit crunch, which is still causing a very volatile situation on the market, the investments in equities, real estate and private equity have dropped sharply in value. Due to the falling oil prices, the return on commodities was also very negative over the last quarter of 2008 (-47.5%). The investments in fixed-income were hit less hard by the credit crunch. This category shows a positive return of +1.0%.

In 2008, the currency risk – more specifically the dollar risk – in the portfolio was largely hedged. In the fourth quarter of 2008, the total return of this currency hedge was positive. In 2008, the interest rate sensitivity of the pension liabilities was also partly hedged in the investment portfolio by extending the duration. Due to the falling interest rate, the effect of the partial interest rate hedge was positive.

Over the past year, the relative share of fixed-income in the investment portfolio increased from 40.4% to 44.8% at the expense of the share of equities and alternative investments. Considering that fixed-income is less risky than equities and alternative investments, this shift ensures that the current portfolio is less risky than would be the case if the old portfolio had been maintained. However, this does not take away the fact that the current markets are still very volatile, and that this volatility works its way through to the investment portfolio.

Key figures

Period	2007	Q1 to Q3 (2008)	Q4 (2008)	2008
(balance at year-end)				
Fund position (%)	**140%**	**118%**	**90%**	**90%**
Capital (€ billion)	**217**	**195**	**173**	**173**
Liabilities (€ billion)	**155**	**166**	**193**	**193**
Actuarial interest rate	**4.9%**	**4.5%**	**3.6%**	**3.6%**
(movements)				
Return on investment portfolio (%)	**3.8%**	**-9.8%**	**-11.5%**	**-20.2%**
Fixed-income	**1.9%**	**-0.5%**	**1.0%**	**0.4%**
Equities and alternative investments	**5.2%**	**-17.5%**	**-23.0%**	**-36.5%**
• Equities (incl. participating interest)	5.3%	-24.1%	-20.2%	-39.4%
• Real estate	-9.4%	-7.2%	-24.5%	-30.0%
• Infrastructure	21.0%	1.5%	-4.5%	-3.1%
• Private equity	29.4%	2.1%	-26.1%	-24.5%
• Commodities	31.0%	2.5%	-47.5%	-46.2%
Other investments	**13.2%**	**0.4%**	**-6.1%**	**-5.7%**
• Hedge funds	14.4%	0.3%	-5.9%	-5.6%
• Innovations	-4.7%	0.4%	-7.9%	-7.5%
(balance at year-end)				
Composition of the investment portfolio (%)				
Fixed-income	40.4	41.6	44.8	44.8
Equities and alternative investments	55.2	53.5	48.9	48.9
Other investments	4.4	4.9	6.3	60.3

NB: All returns include currency hedge and interest rate hedge.

Economic prospects

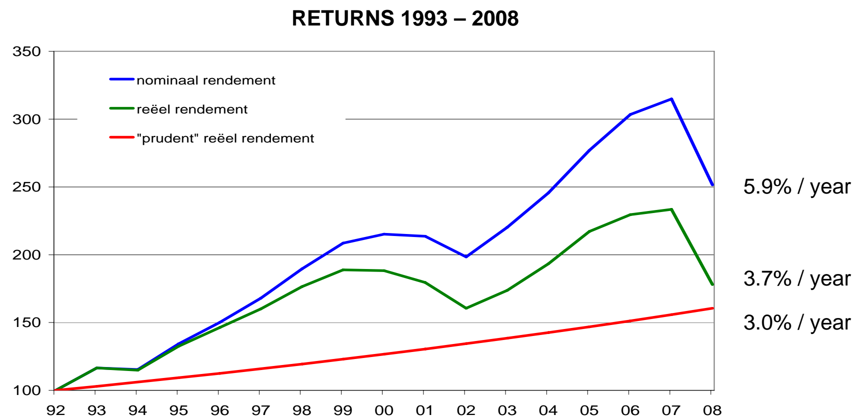
Worrying financial news over the past six months has resulted in even greater unrest on the financial markets and insecurity about future economic growth. The sluggish credit market which the central banks have been trying to normalise without success is key in all this. At the same time, governments all over the world have been drawing up recovery plans and putting them in place. The result of this unrest is that economic growth and inflation prospects have dropped sharply. The falling oil price has even fuelled the possibility of deflation.

The drop in economic growth in 2008 is set to continue in 2009. Consumer confidence has fallen worldwide, in part due to increasing unemployment figures and a weakening housing market. The US, Europe and Japan published weak growth figures for the third quarter of 2008. The increased risk aversion worldwide and the qualms about granting trade credit means that emerging countries have been affected by the fall-out of the credit crunch. Expectations are that consumer spending will weaken, and it is up to the governments to temporarily counterbalance this weakened consumption. A return to normal credit facilities seems essential to restore growth. However, in spite of a number of positive developments in the credit market, it looks like we are nowhere near this situation. Under these circumstances, the expectations are that inflation will continue to fall over the coming months, but structural deflation is not foreseen.

Despite attractively low valuation levels, the question is whether equities will show a structural revival in 2009. Falling operating results and the current insecurity in particular mean that over the first half of 2009 at least the volatility of the financial markets will remain high. Current market prices reflect a long-term recession. Signs of revival are scarce and insecurity remains high.

Long-term return

The diagram below shows the cumulative return from the start of 1993, both in nominal and in real terms. The value of every €100 invested in 1993 had grown to a total of €251 by 31 December 2008. The average annual return is 5.9%. The return after deduction of the wage inflation (real return) is 3.7% over this period.



[nominal return / real return / “prudent" real return]

The overview shows that due to the disappointing results in 2008, the long-term return has fallen considerably. However, the long-term real return is still well above the return assumption of 3% which is applied to calculate the cost-price premium.

The actuarial interest rate in more detail

To determine the forecast return on their capital, pension funds apply a so-called actuarial interest rate. The higher the actuarial interest rate, the higher the forecast return and the easier pension funds are able to meet their future liabilities. In the case of a high forecast return, the future pension liabilities become “less valuable” in accounting terms.

Under the current Pensions Act, pension funds need to value their liabilities using the so-called swap interest. This interest can be compared with the interest on (long-term) government loans. This interest dropped sharply over the past year and it also means the expected return with which pension funds need to work dropped sharply. Because pension funds calculate about 90 years into the future, a drop of the expected return is a big deal and it becomes significantly harder for pension funds to meet their liabilities. The result is that these liabilities become considerably “more expensive”. A drop in the interest rate by one per cent for instance can result in an increase of the liabilities by about 17 per cent!

It is good to remember that this construction is an assumption. The actual return can deviate sharply from the actuarial interest rate. At year-end 2008, the swap interest, or the actuarial interest rate, amounted to 3.6 per cent. This is significantly lower than the actual average return of 5.9 per cent that ABP realised over the past 15 years. If we used this realised return in the future, the liabilities would be tens of percentage points lower and the coverage ratio tens of percentage points higher. However, for reasons of safety, the Pensions Act specifies that pension funds need to calculate with the return that can be made on the capital market risk-free. This is the swap interest.

PROFILE

Stichting Pensioenfonds ABP (ABP) is the sector-specific pension fund for employers and employees in government and educational institutions in the Netherlands. ABP has 2.7 million members and a capital of €173 billion (on 31 December 2008). This makes ABP one of the three largest pension funds in the world.

DISCLAIMER

This announcement contains future expectations. They are based on current assumptions and insights. ABP is not obliged to publicly update these as a result of future insights or events. Furthermore, ABP points out that the expressed expectations are subject to insecurities perforce, as a result of which ultimate returns can substantively deviate, for instance due to unforeseen circumstances in markets relevant to ABP, exchange rates, the interest rate level and developments in legislation. The figures in this document are partly based on estimates and have not been verified by the auditor or external actuary.

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