The Dutch Triangle

A framework to measure upside potential relative to downside risk.

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In 1998 the Dutch government passed a law requiring all pension funds to construct a benchmark that must be used to evaluate performance. We will refer to this as the strategic benchmark. No government guidelines have been established for how this strategic benchmark should be constructed, when it enters the decision framework, or how it affects other investment decisions. In an attempt to answer these questions, the management at Fortis came to realize the importance of a decision framework that provides links among strategic, tactical, and operational pension management decisions. What evolved we call the Dutch triangle.

The Dutch triangle's top-down structure links the various levels of management in a cohesive manner, and provides a link between performance measurement and asset allocation. Because the impact of pension fund performance on corporate earnings is universal, we believe this structure should have global appeal.

Burr [1998] calls attention to a looming management problem. Statistics provided by Gordon Gould, chief actuary at Towers Perrin, indicate that contributions for the fifty largest corporations in America may have to increase by almost $4 billion in the near term and $8 to $12 billion in the immediate ensuing years. The impact this would have on earnings calls for decisions well suited to the Dutch triangle framework.

We demonstrate that style analysis and downside risk are valuable concepts for analyzing risk-return tradeoffs within this framework, in both large and small markets like the United States or the Netherlands. A