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PPI

An International Viewpoint, Bringing the Global Pensions Community Together – Event 3
The Netherlands

These events are aiming to reflect the approach to pensions in other counties. Sometimes the same terminology is used in other countries to describe a different concept than that which we understand it to mean in the UK. Where possible we have tried to clarify this.

The Pensions Policy Institute (PPI) held a seminar on the 5 October 2020, sponsored by **MFS Investment Management**, Gold Supporting Members of the PPI, with special guest Theo Nijman who gave insight into recent developments with the Dutch pension system. The event took place virtually with around 40 attendees.

This is the third of a series of internationally focussed virtual events, exclusively for PPI Governors and Supporting Members. Each event features a leading expert sharing their country's experiences of retirement income and saving, any recent reforms, and offer the opportunity for attendees to ask questions and learn from a different perspective.

Madeline Forrester, Head of Global Consultant Relations, MFS Investment Management & PPI Council Member, chaired the event.

Following welcoming remarks and housekeeping from the Chair, **Erika Salazar, Director, Relationship Management, MFS Investment Management** formally welcomed everyone to the event. Below is her transcript:

"I'm Erika Salazar - Managing Director of Relationship Management at MFS Investment Management, based in the UK but covering the Nordic and Benelux regions.

We are delighted to be sponsoring this series of international discussions comparing and contrasting some of the different approaches to Pension Provision around the Globe.

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For our guests who are not based in the UK, The Pension Policy Institute (PPI) is an educational, independent research organization, with a charitable objective to inform the policy debate on pensions and retirement income provision. The PPI operate at the heart of the UK pensions policy world, and they look to facilitate impactful conversations. The PPI's objective is to inform and promote the long term thinking that is vital to pensions provision, but sometimes hard for elected officials with short term mandates to achieve.

Like the PPI, MFS bases our findings on thorough, long term research and analysis, and collaborative discussions. We hope these discussions will create an opportunity for us all to learn more about best practice globally, and how that might be helpful as we look at our specific regional environments and the challenges and opportunities we face. We'd like this to be a truly interactive session so that we can lean not just from the PPI; but also from each other.

To that end Theo is going to talk about the New Dutch Pension Contract - after many years of negotiations, Dutch employers, employees and government have reached a broadly supported agreement on redesign of the current DB / CDC system of collective supplementary pensions where this transition will take place over the next few years. He will go into detail on what this entails and will also try and pull out learnings for other countries and importantly leave adequate time for us to all discuss during the Q&A.

Thank you very much for attending, and I hope you find the discussion both useful and rewarding."

Expert presentation

The Chair then invited the guest expert, **Theo Nijman, (Scientific Director of Knowledge Network, Netspar)** to speak on the current experience of the Dutch retirement system.

Theo outlined how the fundamental issues faced by the UK and the Netherlands pension systems are similar. These included Pay as You Go systems, adequate investment strategies, the annuitisation of pension funds and how to address the problems of small deferred pension pots.

He explained how political consensus had enabled the Dutch system to start undergoing changes from their current Collective Defined Contribution (CDC) to a reformed system of more individualised personal accounts. He also discussed the elements of fairness that had led to the reformed approach; these include addressing actuarial fairness, a life cycle approach to investment and to address arguments around funding rates.

Theo described the current pension system in the Netherlands which consists of a first pillar of a Pay as You Go minimum income for all, and a second pillar which is CDC and which together target a replacement income of 70% of final wage after 40 years of service. The CDC element means that there is flexibility in attaining the target and that if funding levels are not sufficient, then inflationary increases may not be paid, and in more extreme circumstances the benefits may be cut.

Theo presented data on the funding rates of the largest Dutch pension funds over the past few years. He noted that since the financial crisis in 2008 most schemes have had funding rates below the threshold to enable them to apply inflationary increases. In 2011/12, the funding rate was low enough to require a cut in the benefits for some schemes. Since then there have not yet been cuts, but have been near misses. In response to COVID-19, the threshold rate to cut benefits was lowered from 95% funded to 90% funded, but currently funding levels are less than 90% so the pensions may have to be cut at the end of this year. The reliance on the funding rates of pension schemes as a measure has made them the subject of front page news in the Netherlands.

Theo described the motivations for reform as stemming in part from the funding rates, and the mechanisms for arriving at the funding rate, in particular the discount rate have played a part in reducing trust. Theo also spoke of the unclear link between contributions and benefits and how that drives a lack of trust.

He also explained the conflict of interests between age groups. These included elements of perceived fairness, including actuarial unfairness from contributions that are uniform over age groups, and a different discount factor being used for retirees than for working age people. He also highlighted structural factors such as investment returns that do not reflect the differing needs of particular age groups.

Theo described the two reform options that are offered. He said that the options for fund trustees both have the aim of providing personally trackable pots that give younger people confidence in the sustainability of the system, and incorporating personal characteristics. He described both options as being close to each other, as both are personal accounts with elements of lifestyle investing and are more pure Defined Contribution in the sense that the final income is return dependant and the sponsor is not liable to make up any deficits, nor are there changes in contribution rates. But he introduced a feature which retains a collective element, the Solidarity Reserve.

Theo described the Solidarity Reserve. This is an optional element that trustees may incorporate into the scheme. It is a kind of collective smoothing reserve, into which up to 10% of contributions may be paid. Then in times of good economic circumstances, the solidarity reserve will grow, but in poor economic circumstances money can be taken out to aid accounts.

He then described the differences between the two options, highlighting the top-down approach strategic assert class selection of the “New Contract” in contrast to the bottom-up individual asset approach of the second approach, the “WVP”. Theo suggested that it is not yet clear whether the WVP approach will be allowed to implement a solidarity reserve.

He then went on to address the transition for the current pension savings. These will be transferred into the new regime. Theo discussed the issues they have with allocating the assets from the CDC, particularly for schemes which are not 100% funded. It is felt that applying a funding ratio factor to the assumed liability is a very blunt way of attacking the problem. It does not represent the way that shortfalls are addressed in the current schemes with the impact of a shortfall tending to impact on different groups differently. This remains an issue to be tackled. A further issue remaining to be solved is how to transfer the rights built up in the Pay as You Go scheme, which by definition has no assets to transfer and is estimated to be around 10% of individuals’ pensions wealth.

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Question and answer session

Madeline Forrester then opened the session to the audience to ask questions of the guest speaker, **Theo Nijman**. This portion of the event was held under the Chatham House Rule.

Questions included expanding further on some of the issues raised in Theo's presentation. Topics that were discussed included:

- The extent of individual choice for members within the reform proposals for the Dutch pension system.
- How much support there is for self-employed people within the Dutch pension system and whether that is likely to change after the reforms.
- How the CDC experience operated as something of a conditioning stepping stone from the certainty of Defined Benefit to the less certain Defined Contribution.
- Whether there are any further transparency issues that may arise as a result of the solidarity reserve.
- How the introduction of a lump sum option into the Dutch system may have an impact on tax treatment.
- Whether the presence of pension issues on the front page and knowledge of funding ratios means that the average person is more informed on pension issues in the Netherlands.
- Trustee knowledge requirements and how they compare with British requirements.

Closing remarks

Madeline Forrester then invited Theo Nijman to make closing remarks and closed the event.

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