COUNTRY SPOTLIGHT THE NETHERLANDS

Scale, diversification and sustainability

The Netherlands boasts one of the world's largest and most vibrant pensions investment landscapes. Stephen Bouvier **gets the lowdown from two leading investment managers**

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The basic premise behind a pension fund's investment strategy is simple enough, ABP head of investments Jeroen Schreur explains. As is the case with any other pension fund, ABP, which provides pension and other benefits to Dutch workers in the government and education sector, faces a number of long-term liabilities and risks that it must meet by generating an investment return. Unsurprisingly enough, the fund's starting point is an ALM study from which the investment managers such as Schreur can develop a framework for strategic asset allocation.

According to the September 2016 Willis Towers Watson global ranking, ABP comes in as the world's fifth largest by assets under management. It is also the largest fund in the Netherlands. Joining ABP in the consultant's worldwide top-ten ranking is the Netherlands' number-two fund PFZW. Currently, ABP's total global assets worldwide stand at €380 billion and they are split between what the fund describes as 'real assets' such as equities and fixed-income assets in a ratio of 60:40.

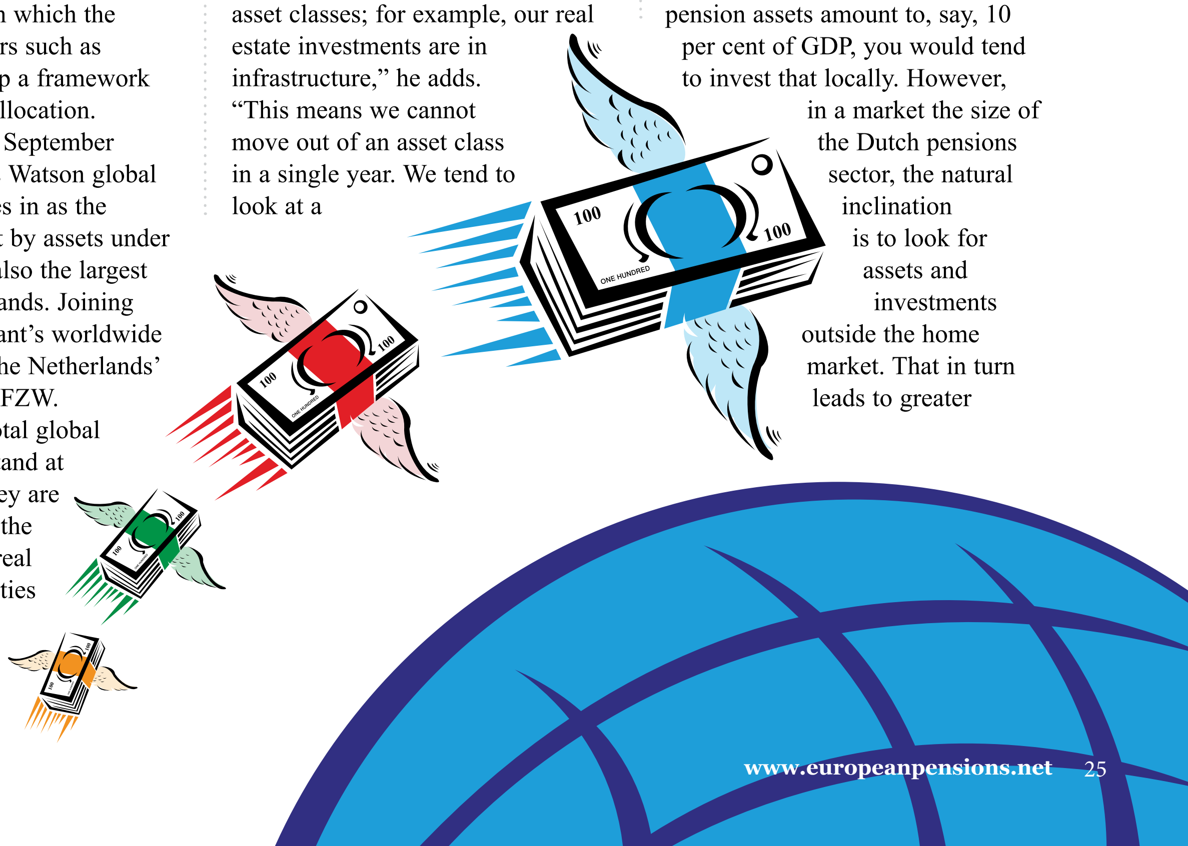
"ABP has to diversify to manage risks and because of its size", says Schreur. "To arrive at an optimal allocation, we run through 5,000 scenarios or so to come up with the best distribution. We look at a number of different asset classes to cover a range of risks such as interest rates, inflation, equity and credit.

"We have a long-term investment strategy and, given our size, we find it quite hard to get into and out of asset classes; for example, our real estate investments are in infrastructure," he adds. "This means we cannot move out of an asset class in a single year. We tend to look at a longer time frame of, say, 15 years and our current profile is a result of decisions that were taken over a long period of time."

Diversity

Indeed, one standout feature of the Dutch pensions investment scene is the sheer diversity of its investments across different asset classes. "The Dutch pension fund market is among the biggest in the world relative to the size of the Dutch economy," explains Robeco Investment Solutions chief investment officer Lukas Daalder. "We have quite sizeable pension assets compared to the size of the economic base and so we have diversified more than other countries.

"If you are a country where your pension assets amount to, say, 10 per cent of GDP, you would tend to invest that locally. However, in a market the size of the Dutch pensions sector, the natural inclination is to look for assets and investments outside the home market. That in turn leads to greater



professionalism. Basically, it is a market in which the players are more aware of the risks and rewards and where they are looking to move into asset classes that other jurisdictions have not looked at yet."

As for the specific trends in recent years, Daalder says one of the key developments that immediately springs to mind is the increased interest in Dutch mortgages. This situation has come about, he believes, because while Dutch banks have quite long positions in mortgages that they are looking to reduce, pension funds at the same time are on the lookout for stable return with an inflation hedging component. And away from home shores, Daalder has also witnessed a growing interest among his clients for emerging market debt.

Ultimately, it should come as no surprise that those investment decisions are simply a reflection of the current investment and macro-economic climate.

"The underlying driver behind these trends is the search for yield," he notes. "In Europe, yields are still quite benign, such as the maximum we see of 50 bps on German 10-year debt. Fundamentally, you are looking at German inflation of 1.7 or so, which basically means you are looking at a loss unless you expect yields to decline again, which I don't."

Schreur takes the view that although ABP's size exposes it to the full panoply of the world's problems, it also opens up to it an equally wide-ranging array of opportunities."We put generating returns in a responsible manner high on the agenda and implementing that has been one of the biggest challenges we have faced. Another is the effects of climate change. It creates all kinds of risk. We need to figure out not only the effects but also make a positive contribution through the investments we make to reduce our carbon footprint."

And another of those challenges that help to make up the investment zeitgeist of which ABP is acutely aware is interest rate risk. "We are heavily exposed to interest rate changes because our liabilities and assets have a certain duration," says Schreur.

"We are confident that we can handle current rate levels, although returns will be lower. Nonetheless, changes to rates are something that we are constantly looking at. We have increased our hedging of interest rates risk. Low or rising interest rates are challenging for a pension fund."

But ask Daalder for his take on risk, and his focus falls on the European Union's woes and the risk of in-built obsolescence.

"There is a concern when you speak with clients about the future of the Eurozone or even the European Union. That comes back go my point about that huge asset base, which is not exclusively invested in Dutch government bonds but also in French and German bonds. If there were to be a Le Pen win in France, you would be talking about the breakup of the Eurozone and a new franc being floated.

"One concern that pension funds should have – especially if they are a relatively young fund – is the risk of disruption. This might, for example, take the shape of a traditional business model that falls prey to a digital disrupter or to a development in, say, robotics. In a relatively short space of time, you could see stable inflows turn into outflows. So, you need a strategy to deal with illiquid assets."

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RI and sustainability

Perhaps surprisingly, given the nature and scale of the potential risks, Schreur believes that a responsible investment (RI) strategy remains the key to sustainable returns. "We want to generate our returns in a responsible and sustainable manner. During 2015, we worked with third-party advisers to review our responsible and sustainable investment policy in order to understand the potential to fully integrate ESG factors into our decision making. Our study proved to us that you can integrate these factors without compromising your return-risk profile, and this is the investment policy that our board has adopted.

"One major change is that we have moved from excluding certain companies to inclusion. This means that we carefully select our investments while focusing on returns with a link to responsible and sustainable investment. We now want to change this situation rather than automatically following a benchmark."

The fund has ambitions to slash its carbon footprint by 25 per cent by 2020. It recently cut the carbon budgets it allocates to its external managers by 10 per cent. "We also want to double our sustainable development investments in line with the UN's sustainable development goals," adds Schreur. They currently stand at €29 billion and ABP wants to push this to €58 billion by 2020, having already made a five-fold increase in its investments in renewables.

As for the progress to date, ABP reports a coverage ratio of to the end of February of 98.8 per cent. The fund posted a return of 9.5 per cent during 2016 against the backdrop of a 6.1 per cent 10-year average.

Nonetheless, Daalder sounds a broad note of caution: "When you look at assets alone: a strong performances in equities and declining yields in bonds have supported returns across the board. However, from a coverage ratio metric, the results have been far less impressive, as the decline in bond yields has led to an increase in the present value of long-term liabilities, more than the assets have." ■