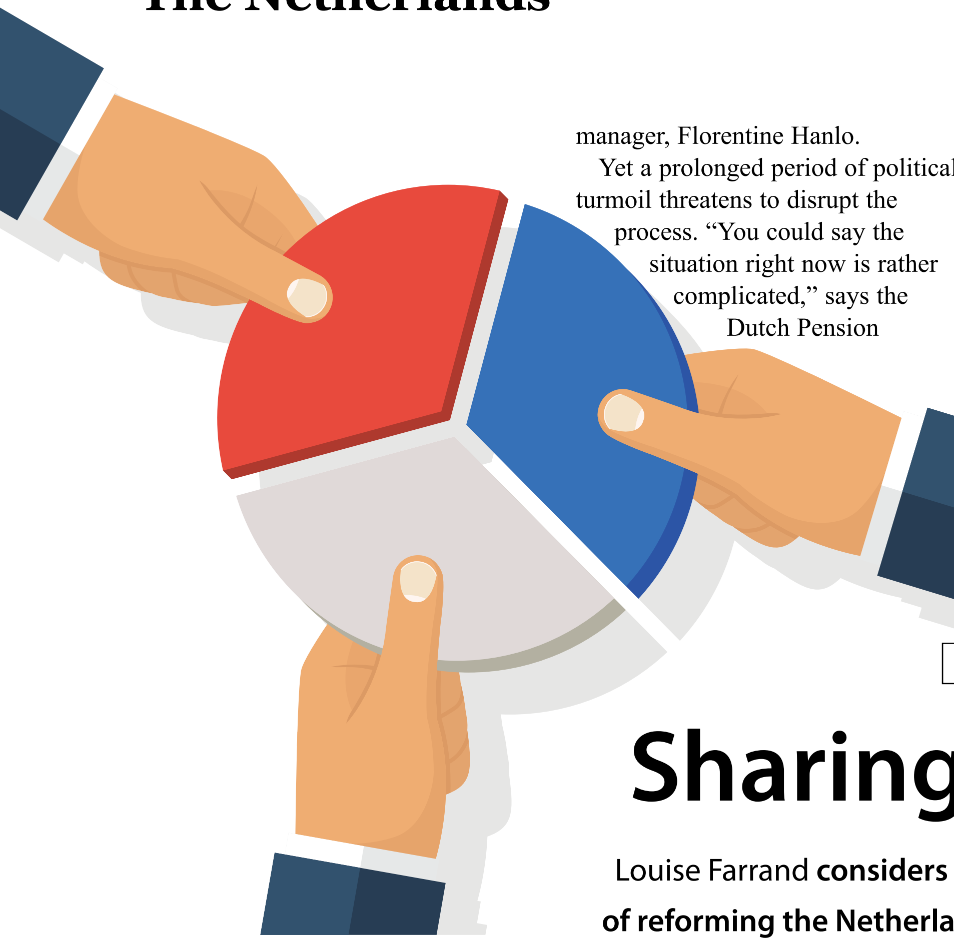

RISK

Sharing the load

Louise Farrand considers the proposals and challenges of reforming the Netherlands' pensions systems to fairly redistribute risk between all parties concerned

WRITTEN BY LOUISE FARRAND, A FREELANCE JOURNALIST

Like most European countries, the Netherlands is coming to terms with the necessity of reforming its pensions system. In the aftermath of the financial crisis, a prolonged period of low interest rates has threatened the sustainability of Dutch pensions. Public confidence in the system has also suffered.

Similar stories are heard across Europe. Where the Netherlands stands out is in its innovative approach to solving some of these common problems. Collectivism and compromise characterise the nation's culture, and pensions are no exception.

Accordingly, the Dutch are bravely forging a compromise route between defined benefit (DB) and defined contribution (DC). "The most significant trend in the Netherlands is that risk is moving from the employer to the employee," explains Kempen's senior fiduciary manager, Florentine Hanlo.

Yet a prolonged period of political turmoil threatens to disrupt the process. "You could say the situation right now is rather complicated," says the Dutch Pension Federation's director, Gerard Riemen. "We had elections in May this year and we still don't have a government."

Heightening the uncertainty is the fact that the different political parties take very different approaches to pensions. One party is in favour of a strictly individual pensions system, while another prefers the system to remain collective, explains Riemen.

In the absence of a government and political consensus, politicians are looking to trade unions and employer organisations to propose solutions. Everyone realises that reforms are inevitable. However, their exact nature is much more difficult to agree, says Riemen.

He summarises the crux of the concerns. "How can you get a better deal for the pensioners, and the people who are working right now, and for the future people who will enter the pensions system? That is a very difficult thing."

Join the collective

As Riemen emphasises, the current proposals could change significantly once the new government is in place. However, as they stand, members will shoulder investment risk in a DC-style accumulation phase, taking the onus off pension institutions and employers. Once workers retire, they will receive benefits, which will vary depending on economic conditions and life expectancy.

As SSGA's senior DC pensions strategist, Jacqueline Lommen, explains: "The new pension contract allows variable benefits in the payout phase of DC schemes. Financial and longevity risk will shift away from pension institutions and employers towards scheme members. In order to protect the scheme members, a – partially compulsory – innovative way of risk sharing is being developed."

"What we are trying to do is keep the collectivity and still share all the risk, but in the accrual phase not promise an accrued pension right," adds Bergamin Pensioenrechtadvies' (in association with Eversheds Sutherland) partner, Eric Bergamin. "Simply say, 'In the end there is an amount of money for you – it exists because you have premiums, investment profits, risk sharing and at the time you retire you can get an annuity. If you get this annuity, it still will be flexible depending on the profits on the investment, depending on longevity risk, inflation risk, et cetera'."

The current proposals also provide scope for retirees to alternatively opt for a retirement annuity income which would be unchanged, whatever the environment of the time. However, this would almost certainly be lower than the income they would receive in exchange for accepting some uncertainty.

There is no perfect solution, and the Dutch system has faced accusations of intergenerational unfairness in the past. It is all too easy for politicians to appease today's retirees with relatively generous benefits, at the expense of future generations who are not following the pensions debate as closely.

This issue is addressed under the new proposals, which state that if people live for longer than expected, they will face a collective cut in retirement benefits. Whether it's possible to set parameters for cuts in a worst-case scenario is "all part of the debate," says Riemen.

Another big question is whether to set aside a pot for emergencies, such as another financial crisis. As Riemen puts it: "Do you have a buffer, how much money do you put in it and when do you use the buffer to prevent a cut of the benefits? That's the intergenerational question."

While much is changing, some elements of the Dutch pension system will remain the same. Saving into a pension will remain mandatory, and investments will continue to be made collectively.

Lessons learned

"The Netherlands is doing what the rest of the world is doing: concluding that DB in its traditional form puts all the risk on the individual employer and we need to find ways of sharing risk. What marks the Netherlands out is its strong basis of strong partners and the collective fabric of society which means it is not going to do what the US, UK, Australia and Germany has done and move right to the other extreme," summarises Eversheds partner and head of pensions, Francois Barker.

As Barker observes, countries' approaches to addressing the same challenges have varied widely. In the UK, the-then pensions minister Steve Webb made headlines when he explored the idea of introducing collective DC in the UK. Since Webb lost his seat in 2015, the idea has lost its highest profile backer and much of its momentum – although UK master trust NEST did prove it was open to the idea in its much-discussed 2015 blueprint for retirement income.

Could we consider a Dutch-style approach in the UK? "I think that boat has sailed," says Barker. "However, there are many other lessons we could learn, around mixing elements of DB and DC. Why does it have to be all one and not a hybrid structure? There are all sorts of imaginative ways you could combine a DB and DC hybrid structure that would learn lessons from the Netherlands."

Making through-retirement investment more collective is another way that other countries – the UK included – could emulate the Dutch. Collective schemes have the luxury of longer-term time horizons, allowing them to access more illiquid asset classes, for instance.

This is an area where Kempen's director of fiduciary management, Wilse Graveland, feels the UK could potentially learn from Dutch pension funds. "My general feeling is there may be too many choices in DC platforms in the UK and that makes it very difficult in accumulation and decumulation to provide a collective. In the Netherlands, by changing the rules, it is all about how can you have a large collective when you have some choices but not too many because it gets very cost inefficient when only one per cent will take a particular option. Focus on which choices you want to provide."

Lost in translation

In some ways, the Dutch system is unique, just like its history and culture. "Unlike the UK, where there is quite a lot of angst and antagonism between management and unions and to some extent companies and trustees … the idea that trustees of a pension scheme could bring down a company is completely anathema to the Dutch," says JLT director Charles Cowling.

He adds: "They would sit around a table and find a way forward that is fair to everybody. The Dutch way of doing things won't necessarily translate to other countries. It fits with the greater collective equality, sharing, society, rather than the 'me first' society that we have in the UK."

Riemen also urges caution when trying to learn lessons from the Dutch. "You have to see the whole picture when designing a pension scheme. We have mandatory pension schemes in the Netherlands. That is a huge difference. It is very important that you look to the whole picture instead of picking out certain features."

"That's one of the reasons why the unions are so hesitant to go along [with the current proposals]," adds Riemen. "They realise that if you take a step in one direction, there is no way back. It's almost impossible to go back to a DB system once you are in a DC system." ■