NETHERLANDS

Going Dutch

The Dutch pension system is seen by many as the model in Europe that other countries should try and emulate. Jack Gray **investigates whether the nation deserves its position as the leading pension system, as well the current challenges it is facing and what the future holds for the country's pension system**

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Like many of its European neighbours, the Netherlands operates a pillared pension system made up of three pillars. The first of which is the General Old Age Pension (AOW), funded by tax revenues and essentially a state pension, ensuring a lifelong basic income for those aged 66 and over. Employees contribute as part of their income tax, which is used to fund the immediate pay outs from the AOW.

The second is a quasi-mandatory occupational section, which aims to provide some extra stability and comfort to workers in retirement. Around 80 per cent of all workplace pension scheme members are covered by compulsory sector-wide schemes, such as teachers and doctors, while more than nine in 10 Dutch workers save into a supplementary second pillar pension.

Third pillar pensions make up the smallest pillar, which are additional private pensions where insurance companies or banks provide benefits to members.

Top marks

In the Mercer *Global Pension Index*, the Netherlands was rated as the best pension system in the world. Of the 37 nations surveyed by Mercer, it received the highest overall score and was one of only two countries, the other being Denmark, to score an A grade. Mercer described those receiving an A for their pension system as having "a first class and robust retirement income system that delivers good benefits, is sustainable and has a high level of integrity". The Netherlands marginally edged out Denmark for the top spot, receiving an overall score of 81, compared to 80.3 for Denmark, up from 80.3 the previous year. The average score was 69.7. Mercer notes that the improved score was partially due to "an increase in the net household saving rate".

Despite finishing top overall, it did not score the highest in any of the three categories assessed by Mercer: Adequacy, sustainability and integrity. It scores very highly for integrity (88.9), but was beaten by

Finland and Norway, while its scores for adequacy and sustainability were lower (78.5 and 78.3 respectively), although they were still way above average in each category.

Commenting on the report, the Dutch Pension Fund Federation noted that the survey highlights that even more could be done to improve the Netherlands' rating. The federation states: "According to the study, the Netherlands could score even higher by reducing household debt and increasing labour market participation among the elderly as life expectancy rises."

Although there is room for improvement, it appears as if most employers, employees and sponsors should be jealous of the Dutch system.

Not all rosy

Despite the positives, the Dutch system is not without its issues. Record low interest rates in the country has led to pension reduction plans due to take effect from January 2020. Interest rates have nearly reached negative levels, and if they continue to fall, there may be further pension cuts for the Netherlands' pensioners.

"In real terms we have money growing in pension funds," begins a Federation of Dutch Pension Funds spokesperson. "It´s just not possible to use it to raise the current pensions because the regulation demands us to use the 'risk-free' interest rate to calculate the liabilities, which is very low nowadays."

The spokesperson explains that asset and liability levels have become unbalanced and that the Federation of Dutch Pension Funds believes that reform could be necessary to avoid any negative outcomes, if interest rates do become negative.

"A pension fund has two sides of the balance. On the one side are the assets, which have grown tremendously, and on the other side are the liabilities, which have grown even more than the assets," they state.

"The reason why we have to calculate the liabilities with a risk-free interest rate is because it is important not to pay out pensions to current pensioners and leave the workers with the risk that there will not be enough pension left for them.

"But now the interest rate is almost negative, this is an extraordinary situation, which was not foreseen when the regulation was made. We asked the minister who is responsible for the pension system to work out a plan to handle this extraordinary situation and maybe adjust the current regulation, also regarding the fact that we will transfer to this new pension contract that is being worked out now.

"We expect him to give more information around the end of November."

Despite this, it may take more convincing of the government and regulators before there is any wholesale reform to the used interest rate. Dutch Central Bank president, Klass Knot, said that the risk-free interest rate was "integral" to the Dutch pension system.

"We will continue to adhere to the risk-free rate of interest," he confirms.

Times are changing

In the Netherlands, the majority of pension schemes are still defined benefit arrangements. However, the country is moving towards a defined contribution system. Although it all seems like a world class system from the outside looking in, in the country "everyone is worried about

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pensions", Dutch Federation of Pension Funds head of Brussels office, Theo Langejan said at the Pensions and Lifetime Savings Association Annual Conference in October.

"You will not find any defined benefit systems" in the Netherlands in 10 years' time, he predicts. "A mandatory defined benefit system is a beautiful system as long as you do not explain it to people.

"There's no need to explain it as long as everything runs fine, but as soon as you get problems in the machine, as soon as you may not be able to meet the expectations, people are going to question you."

It does appear that savers are not as happy as it might be expected, given that their pension system is rated as the best in the world. State Street Global Advisors (SSGA) has produced a report looking into retirement happiness. It finds that there is a large discrepancy between the happiness and confidence of savers and sponsors in the Netherlands.

It reveals that, between the Netherlands, the UK, Ireland, Australia and the USA, the Netherlands ranked lowest for pension happiness, trust in savings systems and ownership of the retirement role. Furthermore, it had the largest discrepancy in expected savings sufficiency in retirement between sponsors and members, with 48 per cent of sponsors believing members could maintain their current lifestyle in retirement, compared to 12 per cent of members.

"It is to be expected that the plan sponsors in the Netherlands still place significant responsibility on the employer given that their defined contribution savings systems are in their infancy," explains SSGA. "Those countries with lower alignment scores, the Netherlands and Ireland in particular, are countries that are in the process of creating more established defined contribution savings systems.

"Policymakers should note that individuals in these countries assume a greater degree of individual ownership than is expected. This is a good foundation for the new retirement savings systems; however, effective guidance and advice could be used to further support this transition."

In June 2019, Dutch employers, unions and the government reached an agreement to reform certain aspects of the Dutch pension system. It includes reducing the minimum required funding ratio, slowing the increase in the state retirement age and altering the method by which pensions are accrued. The changes were agreed in the hope that they would prevent any further cuts to member pensions in the future and are predicted to cost the Dutch government €5 billion annually.

A spokesperson from the Dutch Federation of Pension Funds adds: "The employers and workers organisations came to an agreement last June.

"At the moment, experts are working this agreement out in detail. The government has an ambitious roadmap and plans to have the agreement worked out in Spring 2020."

Green saving

As the Dutch pension system modernises and moved towards a defined contribution structure, it is also becoming more environmentally friendly. More than three quarters of pension schemes in the Netherlands now have a sustainable investment policy and it has three funds and providers on the Principles for Responsible Investment's leaders' group for 2019: Pensioenfonds PNO Media, Stichting Pensioenfonds ABP, and Stichting Pensioenfonds voor de Woningcorporaties. Member engagement and awareness has put pressure on the large Dutch schemes to think about their sustainable investment policies and helped drive the Netherlands to the forefront of greener pensions. ■