COUNTRY SPOTLIGHT NETHERLANDS

Still going Dutch?

The Dutch pension system is consistently ranked highly as an example for other countries to follow. But its recent general election saw pension challenges placed firmly in the spotlight. David Adams **explores the current developments occurring within the Dutch pensions market, and the changes that may yet occur**

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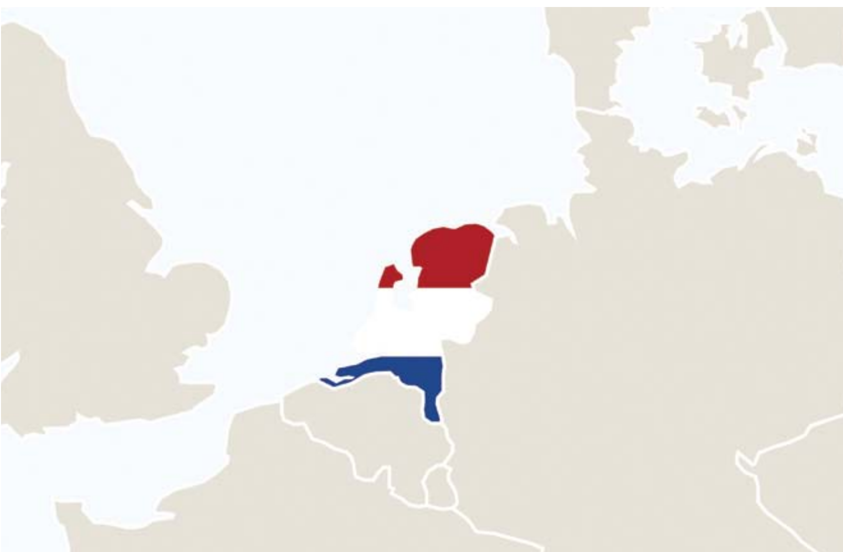

Although some in the Netherlands find this ironic, the Dutch pension system is widely admired around the world for its apparent stability and overall effectiveness. But its admirers do not include those who dislike state involvement and any element of compulsion featuring prominently in pension provision. The Dutch system is based on two pillars: a state pension, in the form of a pay-as-you-go compulsory insurance plan; and a second pillar of occupational pension funds, many of which are collective, industry-wide vehicles.

The state system is based on employee contributions of 17.9 per cent of salary and benefits are currently guaranteed to rise with inflation until 2028. You need to have lived in the Netherlands for at least 50 years between the ages of 15 and 65 to qualify for a full state pension. Early retirement is possible, but only in return for a deduction of 2 per cent for each of year between the date of retirement and the age of 65. Recent reforms mean the state retirement age will increase to 66 in 2020 and to 67 in 2025.

Political interest

It is the second pillar where more dramatic change may be about to take place. March 2017 saw considerably more international interest in a general election in the Netherlands than would usually be the case, as the world waited to see if right-wing, anti-EU, anti-Islam politician Geert Wilders could continue the recent run of election victories for so-called populism, following Brexit and Donald Trump.

Wilders failed: incumbent Prime Minister Mark Rutte and his party, the liberal WD, won the largest number of seats in the Dutch parliament and started to negotiate with other parties to form a new coalition government. While international interest faded at that point, Dutch pension funds and employers have continued to watch the negotiations closely. Major reform of the second pillar had featured prominently during debates between politicians before polling day and is definitely on the political agenda.

"More than I recall from any other election, pensions has been an important topic for discussion," says Willis Towers Watson senior consultant Wichert Hoekert. "The new government may look at revolutionary reshaping of the second pillar."

Second pillar sustainability

Many of the second pillar schemes are industry-wide collective schemes, membership of which is effectively compulsory in some industries. Most of the schemes are defined benefit schemes, with employee contributions usually set between 4-8 per cent of salary. Employer contributions set either by the fund actuary or by an insurer if the latter is backing the plan. There are also some DC plans, for which the employer contribution is usually double the employee contribution.

Upon retirement, individuals no longer have to buy an annuity with a fixed monthly income, but can now also buy a variable income product if they prefer.

The funds have been performing reasonably well, with many delivering investment returns of between 10 and 12 per cent in 2016. But all the schemes are subject to the same challenges that affect pensions across Europe, particularly the low interest rate environment, stock market and economic volatility; and increasing longevity.

“Since the financial crisis it has been clear that the current pension system isn’t sustainable,” says Pensioenfederatie (the Federation of Dutch pension funds) managing director Gerard Riemen. “Almost every year pension funds have to communicate to members that they might have to cut benefits and accrued pension rights – and every year we are lucky that it doesn’t quite happen. So in 2016 Trump was elected, the markets were concerned, interest rates went up and we were saved by the bell.” Indeed, the funding position of the Dutch pension funds, having spent much of 2016 below 100 per cent, recovered to 102 per cent at the very end of the year when interest rates changed.

“This uncertainty and this dependency on interest rate ratios is unsustainable,” says Riemen. “Every year we have a good return on our investments, but funding ratios have gone down. It is hard to explain this to the public, but we know the current situation is not sustainable.”

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Changes ahead?

The primary means by which it is hoped the system will be made more sustainable will be a switch towards more use of DC pensions in some form. More than one model has been suggested, including ‘personal pension accounts’, which would retain some degree of risk-sharing, as in the current collective arrangements, but would make accrual specific to each individual. The rejigged system might also include some sort of intergenerational risk sharing.

“Right now accrual is age-independent: everyone participating in a DB arrangement accrues the same percentage of current wages in future benefits and they pay the same premium independent of age,” says Hoekert. “The proposal is to move to a system where contributions remain age-independent, but accrual becomes age-dependent. So an older person would accrue less. That’s a very complex change and it will have impacts on many aspects of the system, including total benefit packages. There are negotiations taking place already around compensation for members who are adversely affected.” He suggests that many employers still appear to

be unaware of the extent to which this may affect their employees.

In future, individuals are also likely to have much more choice over the fund into which their individual pot is invested. "There is a tendency in parts of our society towards more responsibility for individuals, more freedom to choose your own pension fund," says Riemen. Ultimately this may lead to a system within which individuals might be able to alter contribution rates in order to spend some of their money on other things, such as mortgage payments or healthcare.

Technology will make this easier for individuals, but there will need to be a re-examination and perhaps a redefinition of the employer's role, says Hoekert. "To what extent should they be helping employees to understand these new freedoms?" he asks.

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Falling numbers

Meanwhile, a long-term trend for consolidation of pension schemes continues: the number of schemes has fallen from over 700 a decade ago to about 250 today. Consolidation is taking place among both large and small funds. For example, Pensioenfonds van de Metalektro (PME), the pension fund of the Metal and Electrical Engineering industry, which manages assets worth €44.5 billion and has over 600,000 active, deferred and retired members, has attracted major employers including Siemens and Alcatel-Lucent to join the fund in recent years.

Among smaller funds, in March health insurer pension fund Bedrijfstakpensioenfonds Zorgverzekeraars (SBZ) announced that 16 more employers from the financial sector had joined it. The fund now has around 35,000 members and manages about €525 billion in assets.

Hoekert says he expects the number of funds to continue to fall, in part through this type of consolidation, but also because some will enter buyout arrangements with insurers, while others will join a general pension fund: Algemeen Pensioenfonds (APF). This is a new type of vehicle within which multiple pension funds can be managed collectively, so enabling the cost and efficiency benefits of consolidation, but assets of the individual funds are ringfenced.

"The main reason for those funds to join those APFs will be for governance," says Hoekert. "For small schemes it's increasingly difficult to find the right people to run governance structures. Also, administration costs tend to be lower in an APF. Increasing regulatory requirements from the Dutch Supervisory Authorities make it increasingly difficult for a small scheme to continue on its own.

"The question remains – when is a scheme too small? I don't think there's a generic answer to that question, but it is a question that every fund will have to ask itself."

State pension suggestions

Meanwhile, the election campaign also saw some parties suggesting that the state pension reforms be reversed, with the retirement age brought back to 65. Those parties appear to have lost that argument. Riemen does not expect any more fundamental reform to the state pension in the near future, although there may be some changes to rules for early retirement, possibly allowing a little more flexibility. There may also be further incentives offered to individuals to keep working for longer and to the employers that employ them.

"I don't expect the government to come forward with other proposals," says Riemen. "There is going to be so much happening with the second pillar that with the first pillar it is better to have some calm."

Whatever the new government decides, changes to the second pillar of some kind seem certain during the next five years. Whether or not the system still attracts international admiration after any proposed reforms have been completed is really neither here nor there: the next chapter in the story of pensions in the Netherlands will make a big difference to the lives of millions of people. ■