COUNTRY SPOTLIGHT THE NETHERLANDS

Struggling to fly

Despite its current top billing in the world's pensions rankings, the Dutch pension industry is facing challenges and calls to 'futureproof' the system. The difficulty is determining how this should be achieved. Elizabeth Pfeuti finds out more

WRITTEN BY ELIZABETH PFEUTI, A FREELANCE JOURNALIST

The Dutch pension system has long been held as the standard against which all others should be measured. Its giant, industry-wide schemes and corporate pensions not only pay some of the best benefits in Europe but also have investment portfolios sophisticated enough to rival many global – and smaller – mutual fund managers.

In 2018, it regained the top spot on the Melbourne Mercer Global Pension Index, earning the highest combined scores for sustainability, benefits and integrity. It edged out Denmark, which has become something of a friendly rival in the pensions hit parade, and is worn as a badge of honour by the sector.

But as the year draws to a close, the Netherlands can reflect on overcoming some tricky situations and look forward to several yet to resolve. Its government, unions and society in general seem stuck in deadlock about how to 'futureproof' the pension system, while many of the once unstoppable defined benefit schemes are unable to raise members payments in line with inflation.

The long road to long-term pensions

The intergenerational pension question, although common in other corners of the world, is playing out on the television screens and in the coffee shops of the Netherlands.

Due to a small, regulatory-enforced benefit cut some five years ago, society has developed a lack of confidence in the system, according to Ortec Finance managing director, pension and insurance risk management, Martijn Vos.

"It was totally unexpected," says Vos. "And as a result, a poll of the public showed they thought pensions had become less reliable than banks or insurers."

NN Investment Partners director of institutional business development Harry Horlings says: "What happened in the financial crisis made people realise that benefits were not guarantees, but a financial product. There was a perception of a 'promise' and now this has changed."

With such a strong history of security and benefits, defending the honour of the industry and coming up with a definitive new plan that measures up to what people had before is proving tough. Many expected a new pensions agreement to be published at the start of November, but at the time of writing nothing had been released.

Pushing out retirement ages, increasing discount rates and changing how liabilities are calculated have been mooted to try and break the stalemate.

While retirees are having to deal with benefits not moving up to reflect the increasing cost of living, many younger people feel they are being short-changed entirely.

Cardano Risk Management pension fund adviser Roel Mehlkopf says the changing nature of employment, with people switching jobs and even sectors more frequently than was the case in the past, was also making it a difficult issue to sort out.

"Individuals want both flexibility and a guarantee," said Mehlkopf, "but there has to be a trade-off."

Additionally, due to changes in accrual rates, those aged 45 and above are potentially set to miss out on between €50 billion and €100 billion in their combined pension pot – and no one has yet figured out who is going to pay it.

Ten years ago, the answer could have been to reach into the huge

WHILE RETIREES ARE HAVING TO DEAL WITH BENEFITS NOT MOVING UP TO REFLECT THE INCREASING COST OF LIVING, MANY YOUNGER PEOPLE FEEL THEY ARE BEING SHORT-CHANGED ENTIRELY

cash buffers held by the large pension funds, according to Mehlkopf. Some boasted 170 per cent solvency. Not so today.

Despite pension assets reaching well over €1.3 trillion – the highest they have ever been – few pensions are in what the regulator considers to be adequate health.

Crossing the line

In mid-2018, just 8.5 per cent of all DB funds had the 130 per cent or more funding rate demanded by the central bank, with 24 per cent languishing on less than 105 per cent, according to the industry regulator De Nederlandsche Bank. Consider the picture in 2008, when 56 per cent were at least 130 per cent funded, with none at all below 105 per cent.

This lack of solvency, despite the sector holding its largest-ever asset pile, is due to the discount rate pensions have been forced to use since the financial crisis.

In 2012, the central bank met with fierce protest after it announced liabilities were to be measured using something close to a risk-free rate. This much lower interest rate meant a much higher level of assets was needed to – on an accounting basis at least – meet pension obligations.

At a stroke, some of the country's largest pension funds fell from having more than 170 per cent funding rates to double digit figures, based entirely on new accounting measures.

"It is frustrating," says Kas Bank senior business development manager Bob Meijer. "Some pensions funds are making 6-10 per cent returns, but due to the way the regulator measures liabilities, they are stuck around 100-105 per cent mark."

With a funding level below 110 per cent, pensions are not permitted to increase benefits in line with inflation, meaning the cost of living could outpace payments.

The regulator attempted to ease the pressure by explaining how the discount rate could be "moved up the curve", but implicit mechanisms in the calculations brought it back down again, critics claimed.

"It is hard to explain this to a member who has worked hard all their life," says Meijer. "But the regulator seems more at ease with this prudent method of calculation."

Even the mighty ABP, the world's largest defined benefit pension fund, announced in November that with a funding ratio of just over 102 per cent, it would not be raising its member's benefits in 2019, but added that it doubted it would have to cut them either.

Returning to return

Although growing in operational and investment sophistication due to consolidation – from 447 DB funds at the start of 2007 to 213 by mid-2018, according to the DNB – pension funds have limited options to invest themselves out of this predicament.

"The regulator has a few rules if you drop below 105 per cent funding," says Vos. "You cannot take additional risk. You can change it around within the portfolio but not take on any more."

This failsafe is meant to prevent a pension doubling down, losing more money and becoming a cost burden to society, but it has put even more pressure on investment teams, trustees and their service providers.

Meijer said trustees were increasingly focusing on costs, putting the squeeze on providers while demanding increased amounts of data and information. Consolidation may have made

MANY HAVE SWITCHED THE VEHICLES THEY WERE USING TO PUT THEIR MONEY TO WORK, CHOOSING MANDATES OVER FUNDS, DUE TO BETTER TRANSPARENCY OVER CHARGES AND FEES

these investors savvier, but their well-trained, operational and investment specialist trustees no longer come cheap.

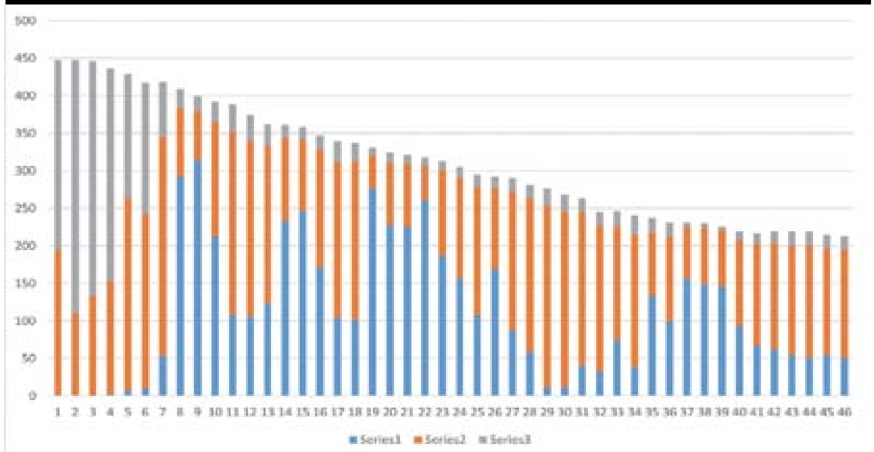
Meijer added that many have switched the vehicles they were using to put their money to work, choosing mandates over funds, due to better transparency over charges and fees.

In this vein, hedge funds, which command some of the industry's largest fees, have proven to be a disappointment for many, according to Northern Trust head of Netherlands Herman Prummel.

"Their risk/return profile, combined with the cost have meant they have not been popular for a few years," Prummel says.

Horlings says the standard blocks of liability-matching assets and growth-seeking portfolios remained, but Dutch and German government bonds are now too low yielding for some to even hold for cashflow purposes.

Dutch pension fund ratio



Investment assets held by Dutch pension funds

Source: De Nederlandsche Bank

"They are finding other ways for them to earn yields in a risk-controlled manner," he adds.

Dutch mortgages have gained momentum over the past eight months, due to their relatively low risk profile – without forgetting the positive societal impact.

Environmental, social and governance investing took hold in the Netherlands more than a decade ago, and quizzing managers on their credentials is routine procedure.

Horlings says investors are already looking for the next step after ESG implementation – where the opportunities to have a social and financial impact could be.

And innovation is going to be key to get many of them back to adequate health.

At the dawn of 2020, some five years after being put on notice by the regulator, pensions less than 105 per cent funded will have some tough decisions to make, says Mehlkopf, signalling that more benefit cuts could be on the way.

As the new year approaches it is a close call on whether the funds have a larger gap to bridge with their funding position – or society. ■