NETHERLANDS

Out with the old, in with the new

With the Netherlands set to move to a new pension system this summer, Jack Gray **investigates the reasons behind the changes and what steps pension funds should be taking in preparation for the switch**

WRITTEN BY JACK GRAY

The Dutch pension system is often ranked amongst the best in the world and is the largest in the EU with €1.71 trillion of assets, as at the first quarter of 2022. Despite this, the world is changing, and transitions in the labour market and outdated pension rules in the Netherlands have sparked the need to switch to a new system. The new rules will bring in an updated pension system, which will shift focus from DB to DC pensions. It will be a contribution-based system and each member's contributions will be allocated to their individual pension capital.

In late December 2022, the Dutch House of Representatives approved the Future Pensions Act. At the time of writing, the bill is in the Senate and voting is expected to be completed before 1 March 2023.

There is widespread acknowledgement in the pensions industry that the changes are necessary, but recent economic uncertainty, improved funding levels and rising interest rates have created questions as to whether now is the right time to change pension rules.

Originally, the rules were due to come into force on 1 January 2023, but this was delayed to 1 July 2023, with Deputy Prime Minister and Minister for Poverty Policy, Participation and Pensions, Carola Schouten, describing the original implementation date as "unrealistic". Pension funds have until 2027 to

"OUR PENSION SYSTEM HAS TO KEEP UP WITH THE TIMES"

switch to the new rules.

On the bright side

"The current pension rules have a number of vulnerabilities," says PMT spokesperson, Ria van der Steen. "The government, the social partners and pension funds see that the rules that are currently in place no longer fit well with these times."

She notes that, under the current system, pension funds must maintain an unnecessarily high buffer and it is therefore difficult to increase pensions. Furthermore, the labour market is shifting to more people being self-employed or having flexible contracts. "That is why it is time for new rules," Van der Steen adds.

Aon Wealth Solutions senior ALM consultant, Corine Reedijk, comments: "With the move to the new system, the standard pension plan will have a DC character and each participant will have their own personal pension capital.

"The system will therefore become more simple, personal and transparent. However, some elements of collectivity and solidarity, and the ambition level of the second pillar pensions, remain in place, preserving some beneficial properties of the current system."

Furthermore, ABP executive board member, Yolanda Verdonk, notes that, according to calculations by De Nederlandsche Bank, the new system will eventually lead to higher pensions.

Pensioen Federatie chair, Ger Jaarsma, explains that, under the current rules, if the economy is doing well pensions sometimes do not increase. "This was the case in recent years, because of stubbornly low interest rates," he says. "The new rules ensure that the pension is more responsive to economic change.

"The new rules do ensure that these economic effects will be dampened for employees close to retirement and people already enjoying retirement. The rationale is that a pension of a younger employee will have more time to absorb investment setbacks than that of older employees."

Potential pitfalls

Despite the wide-ranging positives, there are some potential negatives in the move to the new system. Jaarsma explains that as pensions will move with the economy, there is a chance that pensions will decrease if the economic situation is poor, which will require "a lot of explanation".

Additionally, with the switch from DB to DC, the risk will transfer to the member, which Reedijk says will require clear communication. "The transfer to the new system is a major change. From a 'DB country', the Netherlands will become a 'DC country'. The standard approach is that the accrued pension entitlements in the current DB plans will move to the new system.

"This transition is complex and difficult to explain clearly to employees, so we see some risks related to the practical execution and the communication surrounding the transition," she states.

"All in all, this transition will be the biggest challenge yet for the pensions industry in the Netherlands. For the confidence of participants in the pensions industry, it is of the utmost importance that this transition goes well."

Another issue during the transition will be how to distribute buffers among different groups of participants, Reedijk notes, as buffers are no longer accrued in the new system and can be distributed. "Due to the age-independent premium in the new system, the older actives will accrue less compared to the current system," she states. "The affected participants will need to be compensated.

"Therefore, the active population wants a share of the buffers of

the pension fund to be used for compensation. The retirees want the buffer to make up for the missed indexation of the past years. And then there are deferred participants as well. This will be a difficult puzzle to solve."

Getting prepared

Although the new rules are set to be implemented in July, pension funds have until 2027 to get in line with the requirements. They must decide on which of the contracts they will implement and whether they will transfer accrued benefits to the new system, amongst other things.

"The general picture is that the majority of our sector has gotten off to a good start, has made a plan and will start determining the risk attitude this year," says Jaarsma.

This is backed up by Verdonk, who adds: "The Dutch pension industry is totally committed to be fully prepared in time. Preparations are in full swing. ABP is on track."

Van der Steen details that PMT would like to switch to the new system on 1 January 2026 and is currently working on all the necessary preparations. "There is still a lot to be done, the law still has to go through the Senate and the lower regulations still need to be worked out in more detail," she says. "Funds depend on their elaboration because they can be important for setting up the systems."

In preparation for the new rules, there are many steps that need to be taken. "Social partners must design a new pension contract for our participants," explains Verdonk. "The social partners represent the employers and employees in the government and education sector in the Netherlands. APG, our asset manager and administrator, is giving top priority to the development of a new pension administration system. This immense operation must result

"THIS TRANSITION WILL BE THE BIGGEST CHALLENGE YET FOR THE PENSIONS INDUSTRY"

in a seamless transfer of all pension rights into the new system."

Reedijk states that the important steps, alongside the choice of contract, are deciding whether to transfer benefits, deciding on the necessary compensation, and investigating the risk appetite of members to prepare for the designing of investment policy in the new system.

"By 1 July 2024, social partners need to reach a draft agreement on the type of contract, moving existing benefits to the new system and compensation," she notes.

"So, these items need to be addressed in 2023."

No time like the present

Improved funding levels and rising interest rates in the Netherlands have raised questions as to whether now is the right time to move to the new system. Have these factors reduced the need for the new rules? "No, certainly not," asserts Van der Steen, "because who says that there will not be another fall in interest rates. The system is really in need of renewal.

"Now that interest rates are rising, we hear noises to throw that whole system change in the trash. It was even suggested to determine the interest rate yourself and, for example, to fix it at 2 per cent. There was even a bill for it, and it was rejected."

Verdonk agrees, stating that the weaknesses of the current system are obvious. "Life expectancy was much lower then and people held lifetime jobs," she continues.

"Despite negative returns, we were able to index our pensions for the first time since 2008. Of course, this was good news for our participants, but is very hard explain and may be even harder to understand. This clearly underlines the need for a new system."

Reedijk adds that while the current situation has changed discussions, pension funds were also under pressure to grant higher indexation due to high inflation. "If a fund has stated the intention to transfer existing benefits to the new pension system, then it can make use of an exception to the normally strict indexation rules, allowing higher indexation in anticipation of the move to the new system."

Furthermore, Jaarsma says that the need for new rules goes beyond the current economic situation. He explains that, in the current DB system, it is mandatory to maintain high buffers, especially when the interest rates are low.

"This means, among other things, that many pension funds were not able to increase the pensions for years," he says. "The earlier promise could also not always be fulfilled. For individuals it was unclear how much they and their employers contributed to their pension and there was a call for more clarity.

"In addition, the current pension system is not well suited to the changing labour market. Employees are less likely than in the past to stay with the same employer throughout their lives, and sometimes they become self-employed. But the current pension system is still based on this obsolete notion of lifetime employment.

"That explains the need for new rules: Our pension system has to keep up with the times in order to solve these kinds of vulnerabilities." ■