



## DISCUSSION PAPER PI-1803

### **Apples and oranges: a comparison of the key features of the legislative and regulatory framework for UK and Dutch defined benefit pension schemes (including Dutch CDC Schemes).**

Philip Bennett and Hans van Meerten.

April 2018

ISSN 1367-580X

The Pensions Institute  
Cass Business School  
City, University of London  
106 Bunhill Row  
London EC1Y 8TZ  
UNITED KINGDOM

<http://www.pensions-institute.org/>

# Apples and oranges: a comparison of the key features of the legislative and regulatory framework for UK and Dutch defined benefit pension schemes (including Dutch CDC Schemes)

**Authors: Philip Bennett and Prof. Dr. Hans van Meerten**

**4<sup>th</sup> April, 2018**

**Abstract:** The UK and the Netherlands have different legal and regulatory regimes for defined benefit pension schemes. This paper compares and contrasts the key features of those regimes.

The UK allocates all of the underfunding risk in a UK defined benefit pension scheme to the employer, backed up by the Pension Protection Fund in the event of the insolvency of the employer. In the Netherlands, the risk of an underfunding in a defined benefit scheme or CDC Scheme is shared amongst the members. There is no Pension Protection Fund.

However, the funding standards in the Netherlands are prescriptive (in part because a Dutch pension fund is treated as a “regulatory own fund” for the purposes of Article 17 of the IORP I Directive (Directive 2003/41/EC))<sup>1</sup>. The length of time for making good a deficit is prescribed with the benefits having to be reduced if the deficit is not made good to the required minimum funding standard within 5 years. In the UK defined benefit pension schemes are not regulatory own funds. Funding standards are based on “prudence” and account is taken of support of the employer (the “employer covenant”). Furthermore, there is considerable flexibility in the period over which a deficit in a UK defined benefit pension scheme is to be made good.

A key point to draw out is that in the UK both revaluation of deferred pensions and increases to pensions in payment are, in general, required by legislation. So the revaluation liability and the pension increase liability both have to be taken into account as part of the liabilities of a UK defined benefit pension scheme.

In contrast, in the Netherlands, revaluation of deferred pensions and increases to pensions in payment are, as such, not required by legislation. They are, instead, often provided on a conditional basis (conditional indexation). Conditional indexation is only permitted where there is sufficient funding in the pension scheme to cover the cost.<sup>2</sup>

In the Netherlands, the method of balancing the books (unless the employer has agreed to make additional contributions) is for conditional indexation not to be granted and, if that is not sufficient, for accrued pension rights (whether or not in payment) to be reduced uniformly. In the UK, Section 67 of the Pensions Act 1995, in general, prevents any reduction of accrued pension rights (whether or not in payment) in an ongoing defined benefit pension scheme.

There is considerable overlap in the regulatory regime in the Netherlands for Dutch defined benefit pension schemes and Dutch CDC Schemes. In the UK the current legislative framework does not enable CDC Schemes to be provided. But the UK Government announced in March 2018 that it was looking at legislating to enable CDC Schemes to be put in place. The extreme stress test for Dutch defined benefit schemes and Dutch CDC Schemes, brought about by the 2008 financial crisis, along with the “real life” experience in the Netherlands of operating CDC Schemes can usefully inform the thinking in the UK on the legal and regulatory framework for a UK CDC Scheme which is appropriate for the UK environment.

The paper also looks, briefly, at the issue of intergenerational fairness in Dutch defined benefit pension schemes/CDC Schemes as between younger and older employees in relation to the level of the employer contribution. It raises the issue whether, as a matter of strict analysis, this aspect of intergenerational fairness is based on conflating the concept of the employer contribution rate as an average of individual age related contribution rates with an employer contribution rate which is the same for all employees of all ages. It notes that, in the UK, pension scheme benefit design is a matter for the employer, in agreement where applicable, with the employer’s trade unions. If the employer’s benefit design is to have as its aim the provision of the same level of target retirement income for 2 employees on the same pay but at different ages in respect of a particular year of employment, then it follows that the employer contribution rate will be higher for the older employee and lower for the younger employee.

---

<sup>1</sup> The IORP II Directive (2016/2341/EU) has not been transposed into national legislation, therefore we will use the IORP I Directive as a primary source.

<sup>2</sup> Article 137 of the Pensions Act and Article 15 of the Pension Fund (Financial Assessment Framework) Decree contain framework rules with respect to conditional indexation. See: <http://www.toezicht.dnb.nl/en/2/51-201852.jsp>.

**Apples and oranges: a comparison of the key features of the legislative and regulatory framework for UK and Dutch defined benefit pension schemes (including Dutch CDC Schemes)**

**Authors: Philip Bennett<sup>3</sup> and Prof. Dr. Hans van Meerten<sup>4</sup>  
4<sup>th</sup> April, 2018**

**A. Introduction**

**1. Overview**

- 1.1 In March 2018 the Department for Work & Pensions published a White Paper “Protecting Defined Benefit Pension Schemes (Cm 9591)” which includes the following comment (at page 9):

*“However, following the emergence of parties<sup>5</sup> who are committed to developing Collective Defined Contribution pensions, we are now exploring with them how this might be possible through a more modest change to legislation<sup>6</sup>. This work is in its early days and the extent of changes necessary and the time it will take is unclear – but we are committed to working with those seeking to develop cost effective ways of providing members with security in retirement.”<sup>7</sup>*

- 1.2 As noted in 1.1 above, the UK Government is looking at the possibility of introducing legislation to allow CDC Schemes in the UK.
- 1.3 Unsurprisingly, that legislative approach is likely to be informed by the experience, in the Netherlands, of operating CDC Schemes in the real world (including the extreme “stress test” of the 2008 financial crisis).
- 1.4 This paper compares the main features of the legislative and regulatory approach of the UK and the Netherlands in relation to defined benefit pension schemes (and, in the Netherlands, CDC Schemes).
- 1.5 This paper also aims to reduce misunderstanding when discussing, against a UK legal and regulatory background for defined benefit pension schemes, the relative advantages and disadvantages of Dutch CDC Schemes.

**2. Terminology used: Defined benefit pension schemes and CDC Schemes**

- 2.1 In this paper, the term “defined benefit pension schemes”<sup>8</sup>, includes Dutch Collective Defined Contribution Schemes (“**CDC Schemes**”).
- 2.2 CDC Schemes are not currently permitted under UK legislation.

---

<sup>3</sup> Philip Bennett retired as a partner in Slaughter and May at the end of December 2017 after more than 30 years advising employers and pension funds on the UK legal and pension tax related aspects of their pension schemes (email: pfjb2@bennettfox.com).

<sup>4</sup> Professor of EU Pensions Law at Utrecht University (email: H.vanMeerten@uu.nl).

<sup>5</sup> <https://www.cwu.org/news/cwu-reaches-deal-royal-mail-2/> (see Section 11 of the Agreement).

<sup>6</sup> Than the provisions contained in the Pension Schemes Act 2015 (not yet in force) which include provision for “collective benefit schemes” and which also make a substantial number of consequential changes to the existing UK legislative framework.

<sup>7</sup> See [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/693655/protecting-defined-benefit-pension-schemes.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/693655/protecting-defined-benefit-pension-schemes.pdf). See also the Work & Pensions Select Committee Inquiry into CDC Schemes <http://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/inquiries/parliament-2017/collective-pension-schemes-17-19/>.

<sup>8</sup> i.e. where the member has the right to receive from the pension fund at normal retirement age (e.g. 68) a pension for life based on years of pensionable service and either final pensionable pay or pensionable pay relating to each year of pensionable service.

- 2.3 In summary, it can be said that the main features of a CDC Scheme are:
- ◆ the employer contributions are expressed as a fixed percentage or a fixed amount, so the employer has no legal or constructive obligation to make good any shortfall between the amount of the target benefits in the CDC Scheme and the value of the assets of the CDC Scheme whenever a valuation of the CDC Scheme is done.
  - ◆ the CDC Scheme benefits are expressed as a target retirement income (or target pension) payable for the life of the member (with associated conditional target revaluation in the pre-payment period and conditional target indexation in the post payment starting period to protect the purchasing power of the benefit).
  - ◆ members of a CDC Scheme pool (either intra or inter generationally (or both)) longevity, inflation and investment risks (and rewards) in accordance with the rules for doing that in the CDC Scheme (and subject, where applicable, to overriding legislation).
  - ◆ if the value of the CDC Scheme assets, as at a valuation date, is below the capital value, as at that date, of the CDC Scheme benefits, then future target revaluation and future target indexation does not occur (or is reduced) and if that control mechanism is not sufficient, ultimately the accrued target benefits (both in payment and not yet in payment) are reduced to “balance the books”.
- 2.4 CDC Schemes can also be referred to as target benefit schemes or collective benefit schemes or collective money purchase schemes (but with the main features being those outlined in **2.3** above).
- 2.5 A point to draw out between the UK and the Netherlands is that, as is illustrated later in this paper, the boundary between a Dutch defined benefit pension scheme and a Dutch CDC Scheme is not a “hard” boundary.
- 2.6 Indeed it might be said, by reference to the main features of a CDC Scheme identified in **2.3** above, that the overlap between a Dutch defined benefit pension scheme and a Dutch CDC Scheme is almost complete (the difference being the extent of the employer support for a Dutch defined benefit pension scheme) – not required under Dutch pensions legislation but under the terms of the agreement between the employer and the employees or their recognised trade unions.
- 2.7 In contrast, as illustrated later in this paper, in the UK, if the benefits under the pension scheme are not “pure” money purchase benefits<sup>9</sup>, then the benefits under the scheme are classified as defined benefit benefits and the employer is, directly or indirectly, fully liable to support the pension scheme from which the benefits are being paid.

### **3. Legal structure of UK defined benefit pension schemes**

- 3.1 In terms of legal structure in the UK, the type of defined benefit pension scheme considered in this paper is:

---

<sup>9</sup> See the definition of “money purchase benefits” in Section 181 of the Pension Schemes Act 1993 (as amended by the Pensions Act 2011) – in summary, the scheme provides no guarantee as to the level of benefits (which derive from the contributions paid as adjusted for investment return and expenses).

- ◆ an occupational pension scheme established by one or more employers to provide retirement benefits for their employees,
  - ◆ where the benefit is expressed, under the governing legal documents of the pension scheme (its Trust Deed and Rules), to be a defined benefit pension payable for the life of the member (and, usually, with attaching benefits payable to the surviving spouse, civil partner or other dependants of the member), and
  - ◆ where the legal form of the pension scheme is that of an irrevocable trust.
- 3.2 Under English law, a trust does not have a separate legal personality.
- 3.3 Instead, the Trustee holds the assets of the pension scheme on trust for the purpose of providing the benefits conferred on the members of the pension scheme (and their respective survivors) by the terms of the Trust Deed and Rules (the governing legal documents of the pension scheme) and applicable legislation (see **Table 1** below for further details of key applicable legislation).
- 3.4 The assets of the trust derive from employer contributions, employee contributions, amounts transferred in from other pension schemes and investment income and gains.
- 3.5 The assets are held by the Trustee on irrevocable trust to be applied for the purposes of the pension scheme. In other words, they are bankruptcy remote and protected from the bankruptcy of the employer, the member and the Trustee.
- 3.6 The Trustee of the pension scheme could be a number of individuals or, more usually (and legally safer) a company whose sole purpose is to act as trustee of the pension scheme (and often wholly owned by the sponsoring employer in relation to the pension scheme). Such a company might typically have a paid-up share capital of £2.
- 3.7 From an accounting perspective, the assets and liabilities of a UK defined benefit pension scheme do not appear on the balance sheet of the Trustee, if established as a company (because the Trustee does not own the assets beneficially and only has the obligation to pay benefits to the extent that the assets are sufficient for that purpose).
- 3.8 It should also be noted that a balance sheet of a UK pension scheme does not show the liabilities of the pension scheme to pay benefits (those obligations are to be found in the actuarial valuation of the pension scheme)<sup>10</sup>.

#### **4. Legal structure of Dutch defined benefit pension schemes<sup>11</sup>**

- 4.1 In terms of legal structure, the approach in the Netherlands can be viewed as similar to that in the UK except the references to a trust should be replaced by references to a Stichting<sup>12</sup>.

<sup>10</sup> See the Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, Regulation 3.

<sup>11</sup> The authors would like to thank and acknowledge the contribution of the EU Pension Law section at Utrecht University (Elmar Schmidt, An Wouters and Jorik van Zanden) for their help on the Dutch law sections in the tables of this paper.

<sup>12</sup> All Dutch pension funds established after 2015 are required to have the legal form of a Stichting. However, prior to 2016 it was possible for a Dutch pension fund to have a separate legal personality (e.g a BV) although not established as a Stichting. That said, pension

- 4.2 Under Dutch law, a “Stichting” is a body corporate which has its own separate legal personality (ie. just like any other company).
- 4.3 But a Stichting set up to provide pension benefits has a limited purpose under its constitutional documents of using the assets of the Stichting to provide those benefits to the members of the Stichting (ie. the employer’s employees and the former employees and their respective survivors).
- 4.4 The members derive their rights as against the Stichting from the memorandum and articles of association (or the Pension Regulations) of the Stichting which confer legally enforceable rights to the pension benefits on the member against the Stichting.
- 4.5 The relationships between the interested parties in relation to the Stichting can be analysed as a triangular relationship:
- ◆ **Relationship 1:** Employer to employee (under the contract of employment including any terms incorporated via the collective bargaining agreement between the employer or the employer’s association and the recognised trade union) which provides for the terms on which the employer will make available, via the Stichting, pension benefits. This agreement is called a “*pensioenovereenkomst*” or a Pension Agreement.
  - ◆ **Relationship 2:** Between the employer and the Stichting under which the employer has agreed with the Stichting under a funding agreement as to the amounts (or “premiums”) it will contribute to the Stichting to fund the retirement benefits to be provided by the Stichting to the employees of the employer (and their surviving dependants), which such benefits are more particularly described in the memorandum and articles of association (or Pension Regulations) of the Stichting. This agreement is called a “*uitvoeringsovereenkomst*” or an Administration Agreement.
  - ◆ **Relationship 3:** Between the employee/member (including surviving eligible dependants) and the Stichting. The Stichting is required by the memorandum and articles of association (or Pension Regulations) of the Stichting to make payments to the member (and his or her eligible surviving dependants) of the benefits as determined in accordance with the terms of the memorandum and articles of association (or Pension Regulations) of the Stichting. These arrangements are referred to as the “*pensioenreglement*” or Pension Regulations.
- 4.6 A point to draw out is that, because of the legal form of the Dutch pension fund is a Stichting, its balance sheet will show both the assets and the liabilities (including pensions obligations) within it.
- 4.7 In the Netherlands, it is possible, as an alternative to using a Stichting, for the retirement benefits to be provided:
- ◆ by an insurance company (ie. premiums are paid to the insurance company by the employer to purchase retirement benefits for the employee under an insurance contract), or
  - ◆ as a premium pension institution<sup>13</sup>.

---

funds in the Netherlands are typically established as Stichtings. This paper looks at the position on the basis that the legal form of the pension fund is a Stichting (although, as a practical matter, little turns on this point).

<sup>13</sup> See <http://www.toezicht.dnb.nl/en/2/51-228850.jsp> for more details.

**Note:** Neither of these types of arrangements is, in the interests of relative brevity, considered in this paper.

**B. Comparison of the UK and the Netherlands respective approaches to legislating and regulating in relation to defined benefit pension schemes**

**Table 1** below sets out a comparison of the key features of the approaches of the 2 countries.

**Table 1**

	Issue	UK	Netherlands	Comment
<b>A. <u>Legislative prohibition on compulsory membership</u></b>				
1.	Right to require employee to be a member of a pension scheme	<p>1.1 Statutory prohibition on compulsory membership of a pension scheme.</p> <p><b>Note 1:</b> See the Pension Schemes Act 1993, Section 160 (consolidating what was previously Section 15 of the Social Security Act 1986).</p> <p><b>Note 2:</b> There is a limited exception, from this statutory prohibition, where the active member is not required to pay contributions and the benefits provided from the pension scheme are limited to death benefits.<sup>14</sup></p>	<p>1.1 It is permissible to require an employee of an employer participating in a pension fund to require the employee to be an active member of that pension fund<sup>15</sup>.</p>	<p><b>1.1 An important point to draw out is that there is no right, on opting out of a UK pension scheme, to require the employer to pay the same level of contributions to another pension scheme of the employee's choice.</b></p> <p>1.2 In other words, the employee who opts out, in general, is doing so for "cash flow" reasons. In other words, because of a need to meet current payment obligations out of the contributions the employee would otherwise have to pay to the pension scheme (or because of a desire, on the part of the employee, to increase immediate consumption rather than to defer it for retirement).</p>
<b>B. <u>Legislative protection of accrued benefits</u></b>				
1.	Mandatory vesting of benefits after a minimum period of membership	<p>1.1 It is open to the employer to specify a minimum entry age or a minimum period of service before an employee may become a member of</p>	<p>1.1 A waiting period of up to 2 months may be specified.</p> <p><b>Note 1:</b> Article 14 of the Pensioenwet (the "<b>Dutch Pensions Act</b>").</p> <p><b>Note 2:</b> No waiting periods are permitted for</p>	<p><b>As a practical matter, nothing turns on the differences in approach here between the UK and the Netherlands.</b></p>

<sup>14</sup> The Pension Schemes (Voluntary Contributions Requirements and Voluntary and Compulsory Membership) Regulations 1987, Regulation 3.

<sup>15</sup> For further details, see <http://journals.sagepub.com/doi/pdf/10.1177/1388262717713414>.

	Issue	UK	Netherlands	Comment
		<p>a UK defined benefit pension scheme.</p> <p><b>Note 1:</b> However, any minimum age or any waiting period needs to fall within the appropriate safe harbour to avoid claims for direct or indirect age discrimination<sup>16</sup>.</p> <p><b>Note 2:</b> Under the “auto-enrolment” legislation in the Pensions Act 2008, the employer has a requirement to automatically enrol “in scope” employees<sup>17</sup> into an automatic enrolment compliant pension scheme within 3 months of the employee becoming an “in scope” employee<sup>18</sup>.</p> <p><b>Note 3:</b> In practice, an employer could, in the relatively limited number of defined benefit pension schemes which are still open to new members, have a “feeder” scheme which might provide the minimum level of money purchase benefits to satisfy the auto-enrolment requirements and then allow the employee to join the defined benefit scheme on completing a minimum period of employment or attaining a minimum age.</p>	<p>survivors’ pensions or for disability pensions.</p> <p><b>Note 3:</b> For employees on temporary contracts, a waiting period of up to 26 weeks may apply.<sup>19</sup></p>	
		1.2 Mandatory vesting is required, in general, after, in	1.2 Once any waiting period has been completed, an immediate	(a) As a practical matter, nothing turns on the

<sup>16</sup> See the Equality Act (Age Exceptions for Pension Schemes) Order 2010, Article 6 and also Schedule 1, paragraph 1.

<sup>17</sup> In summary, employees aged at least 22 but under state pension age and earning at least £10,000 a year (see the Pensions Act 2004, Section 3).

<sup>18</sup> See the Pensions Act 2008, Section 4.

<sup>19</sup> The Dutch Civil Code, Article 7:691.



	Issue	UK	Netherlands	Comment
		<p>summary, 2 years of pensionable service<sup>20</sup> as a member of the pension scheme.</p> <p><b>Note 1:</b> Some additional rules apply if the member leaves with less than 2 years' pensionable service where a transfer value may be available or a return of employee (not employer) contributions may be available.</p> <p><b>Note 2:</b> Where the benefit is a money purchase benefit, then mandatory vesting is required after, in summary, 30 days' pensionable service<sup>21</sup>.</p>	<p>vesting of benefits is required.</p>	<p>differences in approach here between the UK and the Netherlands.</p> <p>(b) If a UK CDC Scheme were to be classified as a type of money purchase scheme, then the expected vesting period would, in summary, reduce to 30 days of pensionable service.</p>
2.	Protection of the early leavers: Proportionate benefit requirement	<p>2.1 The early leaver (ie. the deferred member) must be provided, in summary, with a benefit which is proportionate to the benefit of the active member (projected to normal pension age) under the Pension Scheme Rules at the date pensionable service ends (but by reference to pensionable pay/ final pensionable pay at that date).</p> <p><b>Note:</b> See the Pension Schemes Act 1993 and the preservation requirements in Section 69 to 82.</p>	<p>2.1 The early leaver (ie. the deferred member) must be provided with the member's pension entitlements accrued to date of leaving pensionable service.</p> <p><b>Note 1:</b> The Dutch Pensions Act, Article 55(1).</p> <p><b>Note 2:</b> The benefit structure for a Dutch defined pension scheme will provide for uniform accrual of the defined benefit pension.</p>	<p>No substantive difference.</p>
		<p>2.2 The deferred member has a statutory right to an individual transfer value to a qualifying occupational or personal pension scheme whether</p>	<p>2.2 The deferred member has a statutory right to an individual transfer value to a qualifying occupational or personal pension scheme whether within</p>	<p>No practical difference.</p>

<sup>20</sup> See the Pension Schemes Act 1993, Section 71.

<sup>21</sup> See the Pension Schemes Act 1993, Section 71.

	Issue	UK	Netherlands	Comment
		<p>within the UK or outside of the UK.</p> <p><b>Note 1:</b> See the Pension Schemes Act 1993, Part 4ZA, Chapter 1.</p> <p><b>Note 2:</b> The individual transfer value is referred to as the “cash equivalent transfer value” or the “CETV”.</p>	<p>the Netherlands or outside of the Netherlands.</p> <p><b>Note 1:</b> See the Dutch Pensions Act, Articles 70-92.</p>	
3.	Protection of the purchasing power of the deferred pension prior to normal pension age	<p>3.1 Statutory requirement for the deferred defined benefit pension to be revalued before it comes into payment.</p> <p><b>Note:</b> See the Pension Schemes Act 1993, Sections 83 to 86 and Schedule 3 to that Act.</p> <p>3.2 If the pension is a final salary defined benefit pension, the required rate of revaluation is the lower of:</p> <p>(a) the increase in the Consumer Prices Index over the number of complete years in the period from the date pensionable service ends to normal pension age, capped at:</p> <p>(i) 5% compound over the same number of years in respect of pension derived from pensionable service prior to 6<sup>th</sup> April, 2009, and</p> <p>(ii) 2.5% compound over the same number of years in respect of pension derived from pensionable service after 5<sup>th</sup> April, 2009.</p>	<p>3.1 No statutory requirement to provide any level of protection. But it is usual, as a matter of benefit design, for revaluation to be provided on a conditional basis (see below) to protect the purchasing power of the “nominal pension benefits”.</p> <p><b>Note 1:</b> The revaluation will depend on the nature of the pensions agreement. The pension fund is free to choose either the percentage of indexation in relation to wages or prices (<i>waardeviste</i> or <i>welvaartviste aanspraken</i>).</p> <p><b>Note 2:</b> Article 1 of the Dutch Pensions Act defines indexation (“supplement”) as an increase of:</p> <p>(a) a pension right to a pensioner member,</p> <p>(b) a pension entitlement of a deferred member,</p> <p>(c) a pension entitlement of an active member under a defined benefit scheme based on average of fixed pay, or</p> <p>(d) a pension entitlement of the survivor of an active member, deferred member or pensioner member.</p> <p><b>Note 3:</b> Article 13 of the Dutch Pensions Act says: “The Pension Agreement will stipulate whether supplements will be</p>	<p><b>The absence of mandatory revaluation of the deferred pension means that in the Netherlands there is more flexibility, through the use of conditional indexation, to manage extreme outturns by sharing that risk amongst the members of the pension fund rather than concentrating that risk, as is done in the UK, on the employer.</b></p>

	Issue	UK	Netherlands	Comment
		<p><b>Note 1:</b> Special rules apply where pensionable service ended before 1<sup>st</sup> January, 1986.</p> <p><b>Note 2: The revaluation is mandatory and is not affected by the level of funding of the pension scheme.</b></p> <p><b>Note 3:</b> It is permissible for there to be “contractual” revaluation in addition to the statutorily required level of revaluation (but this will depend on what is said in the Trust Deed and Rules).</p> <p><b>Note 4:</b> If the benefit design is “average salary”, then the requirement is that the deferred pension is revalued in the same way as it is revalued for the active member still in pensionable service.<sup>22</sup></p>	<p>granted and, if so, the target level and the conditions applicable to the granting of the supplement”.</p> <p><b>Note 4:</b> Article 95 of the Dutch Pensions Act says that as soon as indexation has been granted, it becomes part of the pension entitlement (regardless of whether indexation has happened on the basis of a conditional or non-conditional indexation clause).</p> <p>3.2 In summary, conditional indexation may only be paid if it can be afforded by the pension fund.</p> <p>3.3 For this purpose “affordability” is determined by reference to the funding level of the pension fund. This is discussed further in <b>Section C</b> of this Table below.</p>	
4.	Protection of purchasing power once the pension is in payment	<p>4.1 Statutory requirement to increase defined benefit pensions in payment.</p> <p><b>Note:</b> See the Pensions Act 1995, Sections 51 to 54.</p> <p>4.2 Requirement for the pension to be increased each year once in payment as follows:</p> <p>(a) by the increase in the Consumer Prices Index capped in respect of pensionable service from 6<sup>th</sup> April, 1997 to 5<sup>th</sup> April, 2005 <b>at 5%</b>, and</p> <p>(b) by the increase in the Consumer</p>	<p>4.1 Indexation is a matter of benefit design.</p> <p>4.2 For further details of indexation of the pensions in payment, see the comments in <b>3</b> above.</p>	<p><b>The absence of mandatory revaluation of the deferred pension means that in the Netherlands there is more flexibility, through the use of conditional indexation, to manage extreme outturns by sharing that risk amongst the members of the pension fund rather than concentrating that risk, as is done in the UK, on the employer.</b></p>

<sup>22</sup> See the Pension Schemes Act 1993, Sections 83 to 86 and Schedule 3 to that Act.

	Issue	UK	Netherlands	Comment
		<p>Prices Index capped in respect of pensionable service after 5<sup>th</sup> April, 2005 <b>at 2.5%,</b></p> <p><b>Note 1: The indexation is mandatory and is not dependent on the level of funding of the pension scheme.</b></p> <p><b>Note 2:</b> It is permissible for there to be “contractual” indexation in addition to the statutorily required level of indexation (but this will depend on what is said in the Trust Deed and Rules).</p> <p><b>Note 3:</b> In addition, special rules apply to the part of the pension derived from “contracted out employment”<sup>23</sup> after 5<sup>th</sup> April, 1988 to 5<sup>th</sup> April, 1997 where there is a statutory requirement to increase annually that part of the pension in payment corresponding to the “guaranteed minimum pension” from “GMP age” (65 for men and 60 for women) by the lower of 3% and the increase in the Consumer Prices Index.</p>		
5.	Protection against reducing accrued benefits	5.1 Section 67 of the Pensions Act 1995, in summary, says that accrued rights (ie. by reference to pensionable service to the date of change and calculated, for active members, as if the active member	5.1 Article 20 of the Dutch Pensions Act includes protection for accrued rights but does not prevent those accrued rights being amended in accordance with the terms of any reserved rights to do so (or in accordance with any mandatory	<b>5.1 Under this approach, the Stichting, prima facie, cannot become insolvent for its pension liabilities because it has a mechanism for “balancing its books”.</b> <sup>26</sup>

<sup>23</sup> i.e. the scheme has “contracted out” of the Second State Pension and has to provide a minimum level of “guaranteed minimum pension” in return for a reduction in the level of employer and employee National Insurance contributions. The option to continue to contract out ended at the start of 6<sup>th</sup> April, 2016.

<sup>26</sup> The Stichting can, of course, become insolvent for its ‘normal’ (ie. non-pension) liabilities. For further analysis as to whether the duty, under Dutch law, for a pension fund to reduce its pension liabilities to “balance its books” is compatible with the correct transposition of

	Issue	UK	Netherlands	Comment
		<p>had left pensionable service immediately before the change) cannot, in general, be amended without member consent. Any reserved power in the Scheme's Trust Deed and Rules is overridden<sup>24</sup>.</p> <p><b>Note:</b> This restriction in Section 67 has been broadly construed and would override a provision that would otherwise allow the Trustee to make reductions to benefits if a valuation of the pension scheme showed that it was underfunded.</p>	<p>obligation on the pension fund to do so).</p> <p><b>Note:</b> See Articles 76, 78, 83 and 134 of the Dutch Pensions Act which allow for pension rights of beneficiaries to be restricted or reduced (ie. they are not fixed).</p> <p>5.2 Under the memorandum and articles of association (or Pensions Regulations) of the Stichting (and Article 134 of the Dutch Pension Act), provision will be made for benefits to be reduced if the scheme is underfunded and cannot recover its Minimum Required Funding Level (see <b>C2</b> of this Table below) over a recovery period (currently 5 years).</p> <p><b>Note:</b> The Articles of Association (or pensions regulations) of the Stichting must contain information about the possibility of benefit reductions in accordance with Article 134.</p> <p>5.3 Where benefits are cut, this is a uniform reduction applied to:</p> <ul style="list-style-type: none"> <li>(a) all pensions in payment,</li> <li>(b) all deferred pensions,</li> <li>(c) all accrued pensions.</li> </ul> <p>5.4 There is an initial permitted 5 year recovery period before any cuts to accrued pension benefits (including those in payment) have to be made. Thereafter cuts to accrued benefits in payment (including those in payment) have to be made on a uniform basis over a 10 year period to bring the value of the scheme's liabilities back in</p>	<p>5.2 In other words, there is no equivalent restriction to the Section 67 restriction which prevents the reserved power to amend benefits to "balance the books" under Dutch law.</p> <p>5.3 Whether the employee has a claim against the employer if there is a reduction in benefits in this underfunding situation will primarily depend on the applicable terms of the contract of employment (including any collective bargaining agreement) applicable to the employee in question (ie. the Pension Agreement).</p> <p>5.4 It is possible that the terms of the Administration Agreement between the employer and the Stichting may make provision for additional payments in this situation (or the funding agreement may just be limited to an agreement to pay contributions for a specified period and to agree, thereafter, separately, the contributions to be paid for another specified period).</p>

Directive 2008/94/EC (see also **Section E2** below of this Table) see H. van Meerten, 'European Ruling on Pensions: second warning for the Netherlands', in: F.A.N.J. Goudappel, E.M.H. Hirsch Ballin (Eds), Democracy and Rule of Law in the European Union. Essays in Honour of Jaap W. de Zwaan. The Hague: Asser Press, 2016, p. 146-154.

<sup>24</sup> See the decision of the Court of Appeal in Aon Trust Corporation v. KPMG given on 28<sup>th</sup> July, 2005 [2005] EWCA Civ. 1004 which decided that the power, under the Trust Deed and Rules, of the trustee to adjust benefits to bring their value back in to line with the value of the scheme was overridden by Section 67.

	Issue	UK	Netherlands	Comment
			<p>to line with the value of the scheme's assets to at least the Minimum Required Funding Level (see <b>C2</b> of this Table below).</p> <p><b>Note:</b> Article 134 of the Dutch Pensions Act says as follows:</p> <p><i>"1. A pension fund may only reduce acquired pension entitlements and pension rights if:</i></p> <p><i>a. the technical provisions and the minimum funding requirements are no longer completely covered by assets;</i></p> <p><i>b. the pension fund is not able, to cover the technical provisions and the minimum funding requirements by assets within a reasonable term without disproportionately comprising the interests of scheme members, deferred beneficiaries, pensionable persons, other entitlement beneficiaries or the employer; and</i></p> <p><i>c. all other available steering instruments, with the exception of the investment policy, have been deployed as developed in the short-term recovery plan referred to in Article 140<sup>25</sup>.</i></p> <p><i>2. A pension fund will inform the scheme members, deferred beneficiaries, pensionable persons and the employer in writing concerning the resolution to reduce pension entitlements and pension rights.</i></p> <p><i>3. The reduction referred to in the first paragraph may not be effected earlier than one month after scheme members, deferred beneficiaries, pensionable persons, employer and supervisory body have been informed thereof."</i></p>	
<b>C. Approach to funding of pension scheme (including Dutch CDC schemes)</b>				
1.	Application of the IORP Directive <sup>27</sup>	1.1 The requirements of Articles 15-17 of the IORP I Directive have been transposed into UK domestic legislation.	<b>1.1 A Dutch "pensioenfondsen"<sup>28</sup> is treated as a regulatory own fund (falling within Article 17 of the IORP I Directive) because it is treated as providing a guarantee of benefits and cover against biometric risk – even though the benefits may</b>	<b>1.1 UK pension funds are almost invariably NOT "regulatory own funds".</b>

<sup>25</sup> In summary, Article 140 lays down a 5 year short-term recovery period to restore the pension fund to the Minimum Required Funding Level (see **C2** of this Table below).

<sup>27</sup> Directive 2003/41/EC (to be replaced by Directive 2016/234/EU by 13<sup>th</sup> January, 2019).

<sup>28</sup> Not all Dutch IORPs are Stichtingen.

	Issue	UK	Netherlands	Comment
			<p><b>be reduced to reflect underfunding.</b></p> <p><b>Note:</b> Article 17 of IORP I is now Article 15 of IORP II.</p>	
		<p>1.2 That relevant legislation is Part 3 of the Pensions Act 2004 and the Occupational Pension Schemes (Scheme Funding) Regulations 2005.</p> <p>1.3 Unless, historically, the pension fund has managed to sever all links with its employer (theoretically possible in the past), a UK pension fund would not be a “regulatory own fund” for the purposes of the IORP Directive, Article 17.</p>	<p>1.2 This means that it is subject to the quantitative funding requirements specified in Articles 17a-d of the IORP I Directive.</p> <p><b>Note:</b> These provisions are transposed into Dutch law by the Dutch Pensions Act, Articles 125a-150 which provides for the Financial Assessment Framework (the “<i>Financieel Toetsingskader</i>” or “FTK”).</p> <p>1.3 Under the FTK, a pension fund must value its assets and liabilities at fair value.</p>	<p><b>1.2 Dutch pension funds are “regulatory own funds”.</b></p>
2.	Qualitative or quantitative requirements on funding	<p>2.1 The funding requirements are qualitative<sup>29</sup>.</p> <p>2.2 the requirement is that prudent assumptions are used.</p> <p>2.3 The assumptions (along with the contribution rates and recovery plan) are determined by the Trustee (and, depending on the Trust Deed and Rules of the pension scheme in question, either agreed by the Trustee with the employer or determined by the Trustee after consulting the employer).</p> <p>2.4 The scheme actuary then establishes the funding position of the pension scheme</p>	<p>2.1 Assumptions on discount rates are prescriptive and are set by De Nederlandsche Bank N.V. (the “Dutch Central Bank”).</p> <p><b>Note:</b> In particular under the FTK, it is necessary to use a discount rate for determining the value of future “nominal pension benefits” (ie. excluding conditional revaluation and conditional indexation) based on the “Ultimate Forward Rate”<sup>32</sup> (ie. the risk free rate derived from the capital markets applicable to the expected duration of the pension in question).</p> <p>2.2 The pension fund must set its funding requirements so that:</p> <p><i>“The probability of the pension fund having less assets at its disposal than the amount of the technical</i></p>	<p><b>2.1 There is no Dutch legislation which requires the employer to make up the deficit in a Dutch pension fund.</b></p> <p><b>2.2 In the UK the employer is always liable to make up the deficit although the period of time over which this happens can, in general, be a lengthy period of time (8 to 12 years or longer).</b></p> <p><b>2.3 But the UK has a considerable more flexible approach to valuation assumptions and the length of recovery periods than in the Netherlands.</b></p>

<sup>29</sup> See Part 3 of the Pensions Act 2004 and the Occupational Pension Schemes (Scheme Funding) Regulations 2005 for the legislative basis for what is said in this column.

<sup>32</sup> This is the rate used within the Solvency II framework for insurers who are also supervised by the Dutch Central Bank.

	Issue	UK	Netherlands	Comment
		<p>based on those assumptions.</p> <p>2.5 The next step is for the Trustee, with the agreement of the employer to determine (or it is determined by the Trustee after consulting the employer if that is the way the Trust Deed and Rules interacts with Part 3 of the Pensions Act 2004), the length of the recovery period and the schedule of contributions.</p> <p>2.6 The actuary then certifies whether the proposed schedule of contributions and recovery plan (under which the valuation deficit is to be removed by the end of the recovery period) is sufficient to repair the deficit in the pension scheme by the end of the recovery period.</p> <p>2.7 Under Section 231 of the Pensions Act 2004, the Pensions Regulator has the power to step in and set aside the assumptions used in the valuation and impose its own assumptions, schedule of contributions and recovery plan.</p> <p><b>Note 1:</b> To date, the Pensions Regulator has used the potential exercise of these powers as a threat in order to persuade the Trustee and the employer to agree on a set of assumptions, recovery plan and schedule of contributions acceptable to the</p>	<p><i>provisions within a year is reduced to 97.5%<sup>33</sup>.</i></p> <p><b>Note:</b> This particular requirement will feed into the risk management process of the pension fund and the investment strategy of the pension fund.</p> <p>2.3 There are 2 funding tests that apply to the pension fund:</p> <p>(a) the fair value of the assets of the pension funds is equal to at least, in summary, <b>105%</b> of the amount of its pension obligations (this would not include future conditional revaluation or conditional indexation) valued using the Ultimate Forward Rate as the discount rate – call this the “<b>Minimum Required Funding Level</b>”.</p> <p>(b) that the fair value of the assets of the pension fund is equal to at least <b>130%</b> of the amount of its pension obligations (this would not include future conditional revaluation or conditional indexation) valued using the Ultimate Forward Rate as the discount rate – call this the “<b>Higher Required Funding Level</b>”.</p> <p><b>Note:</b> The Higher Required Funding Level is relevant to whether the pension fund can grant conditional revaluation and conditional indexation (see further below).</p> <p>2.4 The amount by which the Higher Required Funding Level exceeds the Minimum Required Funding Level can be viewed as a further “solvency buffer”.</p> <p>2.5 Where the funding level of the pension fund has fallen below the Minimum Required Funding Level, the</p>	

<sup>33</sup> See Article 132 of the Dutch Pensions Act.



	Issue	UK	Netherlands	Comment
		<p>Pensions Regulator. This power has been used by the Pensions Regulator once in the last 13 years.<sup>30</sup></p> <p><b>Note 2:</b> However, given the investigation by the Work and Pensions Select Committee into the collapse of Carillion and the very limited use to date by the Pensions Regulator of its Section 231 power, it seems likely that the Pensions Regulator will, in the future, be more proactive in the use (or threatened use) of this power.</p> <p><b>Note 3:</b> However, there is an important practical point. If the Regulator regularly uses this power, then the Regulator will end up, de facto, setting the valuation assumptions which are required to be used (although the position is rendered more complex by the need to take account of the support of the employer (the employer covenant)).</p> <p>2.8 The Pensions Regulator also has a statutory duty, in relation to funding matters under Part 3 of the Pensions Act 2004, to have regard to the sustainability of the employer.<sup>31</sup></p>	<p>pension fund must submit a recovery plan to the Dutch Central Bank which increases the funding position of the pension fund back to the Minimum Required Funding Level within a fixed 10 year period.</p> <p>2.6 If the funding level has not recovered on 5 subsequent consecutive annual valuation dates from the valuation date showing that the Minimum Required Funding Level is not met, then accrued pensions (ie. both in payment and not yet in payment) are to be reduced on a proportionate basis spread over period of 10 years.</p> <p>2.7 Conditional revaluation and conditional indexation cannot be granted during any period when the funding level of the pension fund is below the Minimum Required Funding Level.</p> <p>2.8 Where the funding level of the pension fund is above the Minimum Required Funding Level but not above the Higher Required Funding Level, then conditional indexation may be granted on a proportionate basis<sup>34</sup>.</p>	
3.	Obligation on employer to make up deficit on termination of pension fund	3.1 Section 75 of the Pensions Act 1995 requires the employer to pay off the full deficit (calculated as the	No equivalent provision.	<b>3.1 In the Netherlands it is the benefits that are reduced rather than the employer that has to pay.</b>

<sup>30</sup> <https://www.parliament.uk/documents/commons-committees/work-and-pensions/Carillion/Letter-from-the-Pensions>

<sup>31</sup> The Pensions Act 2004, Section 5(1)(cza) "to minimise any adverse impact on the sustainable growth of an employer".

<sup>34</sup> For a convenient summary, see "An Outsider's Summary of the Dutch Pension System" October 2017 published by The Pew Charitable Trusts at page 4 <http://www.icpmnetwork.com/wp-content/uploads/2016/05/AnOutsidersSummaryoftheDutchSystem.pdf>

	Issue	UK	Netherlands	Comment
	(and in certain other events)	<p>costs of securing the plan benefits for the active members (now deferred), the deferred members and the pensioners with an insurance company) if a Section 75 “trigger event” occurs.</p> <p><b>Note 1:</b> This is referred to as the “<b>Buy-out Basis</b>”.</p> <p><b>Note 2:</b> In summary, the “Section 75 trigger events” are insolvency of the employer, members’ voluntary winding-up while solvent of the employer or the winding-up of the pension scheme starting and, in a multi-employer scheme, one employer ceasing to employ active members at a time when another employer continues to employ active members.</p> <p>3.2 The Section 75 debt is a statutory debt recoverable from the employer.</p> <p>3.3 There may be additional “contractual” payment obligation on the employer or other group companies deriving from the terms of the Trust Deed and Rules of the pension scheme in question or any guarantees given to the pension scheme trustee by other group companies.</p>		<p><b>3.2 The exception is where the employer:</b></p> <p><b>(a) has agreed under its Administration Agreement (or Funding Agreement) with the Stichting to make good the shortfall (which would not be the case in multi-employer traditional defined benefit schemes or in the case of CDC schemes), or</b></p> <p><b>(b) has agreed, directly or indirectly, with its employees under the contract of employment (or Pension Agreement) to procure that a particular level of benefits are provided, in which case the employee would have a right for breach of contract to claim damages.</b></p>
4.	Powers of the pension scheme regulator to require contributions to be paid and additional support to be provided to	The Pensions Regulator has extensive “moral hazard” powers:	No corresponding provision.	<b>4.1 Because the way the in which the “books are balanced” in a Dutch pension fund are, ultimately, based on not granting future conditional</b>

	Issue	UK	Netherlands	Comment
	the pension scheme.	<p>(a) <b>contribution notices</b><sup>35</sup>: to require additional contributions to be paid to the pension scheme via the service of a contribution notice on the employer (or any other group company or other person connected or associated with the employer (<b>including employees and directors</b>)) to meet the deficit, calculated on the Buy-out Basis, of the pension scheme, and</p> <p>(b) <b>financial support directions</b><sup>36</sup>: where the scheme is “insufficiently resourced” or the employer is a service company to require “financial support” in the form of guarantees to be provided by anyone connected or associated with the employer (<b>excluding directors or employees</b>) to support the pension scheme.</p>		<b>indexation and, if necessary, on reducing accrued pension rights, there is no corresponding need for powers of a Pensions Regulator to impose additional funding obligations on the employer or associated or connected persons.</b>
<b>D. Restrictions on investing assets of the pension scheme</b>				
1.	Article 12 and Article 18 of the IORP I Directive sets out the requirements in relation to the investment of the assets of the pension scheme	<p>1.1 This has been transposed into UK law via the Pensions Act 1995, Section 34 to 36 and the Occupational Pension Schemes (Scheme Investment) Regulations 2005.</p> <p>1.2 In summary, the restrictions on investment (leaving to one side employer related investments) are qualitative in nature.</p>	<p>1.1 Article 12 and Article 18 of the IORP I Directive equally applies in the Netherlands.</p> <p>1.2 These articles have been transposed into Dutch legislation and are to be found in, inter alia, Articles 46a, 112, 113 and 145 of the Dutch Pensions Act (Article 12 of IORP I) and Article 135 of the Dutch Pensions Act (Article 18 IORP I).</p>	<b>No substantive difference.</b>

<sup>35</sup> See Sections 38 to 42 of the Pensions Act 2004.

<sup>36</sup> See Sections 43 to 51 of the Pensions Act 2004.

	Issue	UK	Netherlands	Comment
		1.3 The requirement is to invest as a prudent person having regard to certain specified factors (generally those referred to in the IORP Directive, Article 18).		
<b>E. Protection of pension benefits in the event of employer insolvency</b>				
1.	Amount of claim on the employer	<p>1.1 The pension scheme trustee will have a claim on employer for any unpaid contributions payable in accordance with the Schedule of Contributions falling due for payment prior to the date of the employer insolvency.</p> <p>1.2 In addition, the insolvency of the employer will (in the absence of a “scheme rescue”) result in the employer having to pay its statutory Section 75 debt to the pension scheme.</p> <p>1.3 In respect of the claims referred to in 1.1 and 1.2 above, unless the pension scheme trustee has obtained security from the employer, the trustee of the pension scheme will rank as an unsecured creditor.</p> <p>1.4 In addition, there is an obligation on the Government to make payments of arrears of contributions to the pension scheme on the occurrence of the employer’s insolvency where those arrears satisfy certain criteria including that they</p>	<p>1.1 The Stichting will claim on employer for any arrears of contributions payable under the Administration Agreement (or funding agreement) in place between the Stichting and the employer.</p> <p>1.2 The Stichting will rank as an unsecured creditor<sup>37</sup> for contributions falling due for payment prior to the insolvency of the employer. Until the employer’s participation in the pension scheme is terminated by the trustee in bankruptcy, contributions falling due for payment after insolvency are claims on the assets held by the trustee in bankruptcy which will be paid out ahead of liabilities relating to periods prior to the date of insolvency of the employer.</p> <p>1.3 The Dutch Employee Insurance Agency (the “Uitvoeringsorgaan Werknemerverzekeringen” or “UWV”) will take over the employer’s obligation<sup>38</sup> to pay pension contributions in a situation where the employee would otherwise lose his or her pension rights because of the employer’s non-payment of the pension fund contributions.</p> <p><b>Note 1:</b> This type of payment would be</p>	<p><b>In practical terms, no substantive claim on the employer by a Stichting (reflecting that any underfunding results in not granting (or reducing) future conditional indexation and, if necessary, reducing the members’ accrued pension rights (whether or not in payment).</b></p>

<sup>37</sup> For further details see paper <http://www.debrauw.com/wp-content/uploads/NEWS%20-%20PUBLICATIONS/INSOL-Pensions-Insolvency-in-the-Netherlands.pdf>

<sup>38</sup> See the Dutch Unemployment Benefits Act (Werkloosheidswet), Article 61 together with Article 64.

	Issue	UK	Netherlands	Comment
		<p>fell due for payment in the 12 month period immediately before the insolvency of the employer.</p> <p><b>Note 1:</b> See the Pension Schemes Act 1993, Sections 123 to 127.</p> <p><b>Note 2:</b> This Section gives effect to Directive 80/987/EEC (on Protection of Employees in the Event of the Insolvency of their Employer) which was, in turn, replaced by Directive 2008/94/EC (the “<b>EU Insolvency Directive</b>”).</p>	<p>covered for the period of no longer than 1 year.</p> <p><b>Note 2:</b> This legislation gives effect to Directive 80/987/EEC (on Protection of Employees in the Event of the Insolvency of their Employer) which was, in turn, replaced by Directive 2008/94/EC (the “<b>EU Insolvency Directive</b>”).</p> <p>1.4 No equivalent to Section 75 of the UK Pensions Act 1995.</p> <p>1.5 Benefit obligations of pension scheme are adjusted so as to match available assets of pension scheme (ie. so pension scheme continues to pay benefits).</p>	
2.	Pension Protection Fund?	<p>2.1 Under the Pensions Act 2004 provision is made for a pension protection fund.</p> <p>2.2 If the employer becomes insolvent and the assets of the pension scheme are insufficient (after any recovery under 1 above) to secure, from an insurance company, benefits at a level which is at least as good as that provided by way of compensation from the Pension Protection Fund, then:</p> <p>(a) the assets of the pension scheme are transferred to the Pension Protection Fund, and</p> <p>(b) the Pension Protection Fund provides compensation payments (in place of the previous</p>	<p>2.1 Under Dutch legislation, no provision is made for a Pension Protection Fund.</p> <p>2.2 Reliance, instead, is placed on the strict funding standards for delivery of the nominal pension benefits (with the additional solvency buffer and with the conditional revaluation and conditional indexation serving as further buffers where that is part of the benefit design).</p> <p>2.3 The analysis is that there is no requirement to have a pension protection fund in order to comply with Article 8 of the Insolvency Directive.</p> <p>2.4 The reason for this conclusion is that the solvency or insolvency of the employer is not related to whether benefits are or are not reduced.</p> <p>2.5 Instead, benefits are reduced where the assets</p>	<p><b>In the Netherlands, it is said that there is no need for a pension protection fund as member benefits reduce on a pro rata basis to make good any under funding whether before or after employer insolvency.<sup>44</sup></b></p>

<sup>44</sup> The Stichting can, of course, become insolvent for its ‘normal’ (ie. non-pension) liabilities. For further analysis as to whether the duty, under Dutch law, for a pension fund to reduce its pension liabilities to “balance its books” is compatible with the correct transposition of Directive 2008/94/EC (see also **Section E2** below of this Table) see H. van Meerten, ‘European Ruling on Pensions: second warning for the Netherlands’, in: F.A.N.J Goudappel, E.M.H. Hirsch Ballin (Eds), Democracy and Rule of Law in the European Union. Essays in Honour of Jaap W. de Zwaan. The Hague: Asser Press, 2016, p. 146-154.

	Issue	UK	Netherlands	Comment
		<p>pensions and deferred pensions) to the members of the pension scheme.</p> <p><b>Note 1:</b> The level of compensation, in summary, is as follows:</p> <p>(a) if the member has attained his or her “normal pension age”<sup>39</sup> for Pension Protection Fund purposes, then the member’s pension continues to be paid. But indexation is limited to the part of the pension accrued post 5<sup>th</sup> April, 1997 and is capped at the lower of 2.5% and the increase in the CPI.</p> <p>(b) for a member who has not yet attained normal pension age, the position, in summary, is as for (a) above, but with 2 further restrictions:</p> <p>(i) the member’s pension is reduced by 10%, and</p> <p>(ii) there is a cap on the maximum amount of compensation payable to the member in the region of £35,000<sup>40</sup> a year.</p> <p><b>Note 2:</b> The introduction of the Pension Protection Fund (and the associated Financial Assistance Scheme applicable to insolvencies of employers before 6<sup>th</sup> April, 2005) were influenced by the</p>	<p>of the pension fund are insufficient to cover the liabilities of the pension fund after allowing for the recovery mechanisms referred to in <b>C2.5</b> above of this Table.</p> <p><b>Note:</b> This, in part, is a function of the employer having no mandatory obligation under Dutch law to make up a deficit in the pension fund in contrast to the position in the UK.</p> <p>2.6 As a practical matter, it should be noted that, given the strict funding requirements and the pro rata basis on which benefits are reduced as between those in receipt of pension and those not yet in receipt of pension, it is highly unlikely (although theoretically possible) that the level of reduction to a member’s accrued pension benefits (whether or not in payment) would ever be greater than 50% (the threshold identified in the cited Robins and Hogan decisions of the Court of Justice of the European Union).<sup>43</sup></p>	

<sup>39</sup> In summary, the earliest age the member can draw his or her benefits as of right (and without any reduction for early payment), ignoring special circumstances such as ill-health.

<sup>40</sup> The applicable cap after applying the 10% reduction for a member with a normal pension age of 65 is £35,105.56 from 1<sup>st</sup> April, 2018 (special rules apply for long service and there is currently (ie in April 2018) a case before the CJEU (Grenville Hampshire v. The Board of the Pension Protection Fund and the Department of Work and Pensions (Case C-17/17)) as to whether the cap should never be less than approximately 50% of the member’s accrued pension.

<sup>43</sup> ECJ Case C 278/05 decided on 25<sup>th</sup> January, 2007 and ECJ Case C. 398/11 decided on 25<sup>th</sup> April, 2013.

	Issue	UK	Netherlands	Comment
		<p>litigation that led to the decision of the European Court of Justice in <i>Robins v. Secretary of State for Work and Pensions</i><sup>41</sup> which specified that the UK had failed to transpose correctly Article 8 of Directive 80/987/EEC into UK domestic legislation.</p> <p><b>Note 3:</b> The European Court of Justice (now called the Court of Justice of the European Union) came to the same decision in relation to Irish pension funds in <i>Hogan v. Ireland</i><sup>42</sup> (relating to the Waterford Crystal Pension Schemes).</p> <p><b>Note 4:</b> Both the <i>Robins</i> case and the <i>Hogan</i> case relate to the correct transposition (or lack of correct transposition) of Article 8 of the EU Insolvency Directive in question.</p>		

**C. Some points to note on the reduction of benefits under Dutch defined benefit pension schemes and Dutch CDC Schemes**

1. The first CDC Schemes started in the Netherlands in 2004.
2. The benefit structure, is in general, an average salary benefit structure with conditional revaluation before the pension comes into payment and conditional indexation once the pension is in payment.
3. CDC Schemes were introduced in the Netherlands by way of response to changes in accounting standards which had the effect of bringing the deficits in Dutch defined benefit schemes on to the balance sheet of Dutch companies.
4. So the CDC Scheme provided a similar benefit structure to a traditional Dutch defined benefit pension scheme providing average salary benefits, but with the employer contribution rate being fixed as a percentage of pensionable pay (but for a period of

<sup>41</sup> ECJ Case C 278/05 decided on 25<sup>th</sup> January, 2007.

<sup>42</sup> ECJ Case C. 398/11 decided on 25<sup>th</sup> April, 2013.

no more than 5 years<sup>45</sup>). The key point is that, even if the employer contribution rate is re-negotiated after the end of that period, of up to 5 years, there would be no requirement to pay any deficit make up contributions.

5. However, the funding regime and other attributes of regulation of the Dutch CDC Scheme, including in relation to conditional revaluation and conditional indexation, seem similar to those for a “traditional” Dutch defined benefit pension scheme.
6. A point to draw out is that, in many ways, the “traditional” Dutch defined benefit pension scheme which provides average salary benefits with conditional revaluation and conditional indexation is the same as the Dutch CDC Scheme.
7. In terms of outturns for members, if the liabilities of the scheme (ie. the technical provisions) plus the solvency margin exceed the value of the assets of the scheme, then:
  - 7.1 there is no future conditional revaluation and no future conditional indexation granted (because it is conditional on the revaluation and indexation being affordable (measured by reference to the margin by which the value of the scheme’s assets exceeds the value of the scheme’s accrued “nominal” or “guaranteed” liabilities plus a buffer)),
  - 7.2 if the deficit is not made good along with the required “buffer” or “solvency margin” within a 5 year period (to restore the funding position back to the Minimum Required Funding Level), then it will be necessary to reduce the “nominal” benefits (whether in payment, in deferment or accrued for active members) in order to balance the books over a period of 10 years by equal reductions.

**Note:** For further detail, see **Table 1, Section C, Row 2.**

8. The impact of the financial crisis on traditional Dutch defined benefit pension schemes has included the following:
  - 8.1 in some schemes pensions had to be cut by 20% (although this was done gradually over a 10 year period),
  - 8.2 in other schemes there has been no conditional indexation granted for 10 or more years,
  - 8.3 however, the reduction in nominal amount of the pensions during the financial crisis was 2-6%<sup>46</sup>.

#### **D. Intergenerational fairness issues and Dutch pension schemes**

1. It appears that the starting point, in relation to a Dutch defined pension scheme or a Dutch CDC scheme, is that the employer contribution rate, expressed as a percentage of pensionable pay, is often communicated as being the same for:
  - ◆ the younger employee, and

<sup>45</sup> The Dutch Central Bank considers it inadvisable to fix the contribution to a Dutch CDC Scheme for a period of more than 5 years. It goes on to say “Fixing the contribution for a period of more than five years might result in unduly large deviations from the actual life expectancy trend and the interest rate used in discounting commitments.” <http://www.toezicht.dnb.nl/en/3/51-228388.jsp>

<sup>46</sup> For source, see footnote 297 of Chapter 6 of the Independent Review of Retirement Income by Professor David Blake published on 2<sup>nd</sup> March, 2016 <https://www.pensions-institute.org/IRRIFrontMatter.pdf>



- ◆ the older employee.
2. In other words, if the employer contribution were expressed as 15% of pensionable pay, the contribution paid by the employer for:
    - ◆ a 25 year old employee earning €30,000 a year of pensionable pay, and
    - ◆ a 55 year old employee earning €30,000 a year of pensionable pay,
 with each employee doing the same work (and therefore being paid the same) leads, by necessary consequence, to the conclusion that the younger employee's employer contribution is supporting the older employee's target benefits.
  3. Why is this? The answer is that the target pension benefit for a scheme year for the 25 year old employee may cost as little as a contribution of 5% of pensionable pay of that employee for that scheme year. In contrast, the target pension benefit for the same scheme year for the 55 year old employee may cost as much as 25% of pensionable pay of that employee for that scheme year.<sup>47</sup>
  4. Unsurprisingly, the younger employee will make the point that he or she is only prepared to accept this cross subsidy if there is an expected continuing supply of future younger employees to come in to the pension scheme so that, over an employee's working lifetime, in the younger years the employee over contributes and in the older years the cost of the employee's target benefit is supported by the excess contributions of the younger generation of employees.
  5. In the UK, it is permissible for an employer to determine that the employer contribution rate for the 55 year old should, for a scheme year, be 25% of pensionable pay and the contribution rate for the 25 year old should, for the same scheme year, be 5% of pensionable pay (where the aim is to produce, for the 2 employees doing the same work in the same year, the same level of "real"<sup>48</sup> target retirement income for that year of work when each employee reaches his or her normal retirement age).
  6. The particular employer contribution rates need to be justified actuarially. Subject to that, this differentiation on grounds of age is, in the UK, specifically excepted from the age discrimination rules.<sup>49</sup>

## **E. Conclusions**

1. The following conclusions emerge from this comparison of the legal and regulatory systems between the UK and the Netherlands:

---

<sup>47</sup> See for more detail (in Dutch): A.J. van de Griend, H. van Meerten, 'Hervorming pensioenstelsel: degressieve opbouw in uitkeringsovereenkomsten en vlakke premies in premieovereenkomsten', *Sociaal Economische Wetgeving*, 2017/ 5, p. 189-198. To be found at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3003304](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3003304).

<sup>48</sup> With the purchasing power protected against inflation through conditional revaluation and conditional indexation (recognising that the 25 year old employee may not draw that target retirement income until 40 years later while the 55 year old employee may draw that target retirement income 10 or 12 years later).

<sup>49</sup> See the Equality Act (Age Exceptions for Pension Schemes) Order, Schedule 1, paragraph 4. It must be remembered that this type of exception is capable of being overridden by the general principle prohibiting discrimination on grounds of age which is part of overriding EU law (see, for example, *Dansk Industri v. Rasmussen* (Case C-441/14 - judgment given on 19<sup>th</sup> April, 2016). See: H. van Meerten, E.S. Schmidt, 'An Overview of EU Case Law: Consumer Protection as the Guiding Principle in Financial Services', *Pension & Longevity Risk Transfer for Institutional Investors*, 2016 for further analysis. That said, if this exception were to be overridden, then it would lead to the conclusion that all defined benefit pension schemes were, at least indirectly, age discriminatory because the cost of providing the benefit for the younger member is lower than the cost of providing the benefit for the older member (and the argument would then be that this was a proportionate means of fulfilling a legitimate aim).

- 1.1 In the UK, the risk in relation to the provision of defined benefits is placed very firmly on the employer. The guarantees in relation to defined benefits in the UK are “hard guarantees”.
  - 1.2 In the Netherlands, the risk is borne collectively by the members of the pension fund unless the employer has separately agreed with the employees or their representatives to pay additional contributions to make up a shortfall.
  - 1.3 There is less flexibility in relation to defined benefit pension scheme benefit design in the UK than there is in the Netherlands because of the requirement for mandatory indexation of the defined benefit pension in payment (and, depending on the type of defined benefit pension scheme, the mandatory revaluation of the deferred pension before it comes into payment). Both this mandatory revaluation and mandatory indexation reduce the flexibility for dealing with shocks to the pension system such as the 2008 financial crisis.
  - 1.4 In contrast, in the Netherlands, the conditional revaluation and conditional indexation provides a mechanism for cushioning the “nominal” level of accrued pension to decrease the risk of that nominal level being reduced.
  - 1.5 In terms of flexibility for determining valuation assumptions and for making good deficits in pension schemes, the UK offers considerable flexibility. In contrast, in the Netherlands, assumptions are prescribed (particularly the discount rate) and there are fixed periods within which a recovery plan must restore the required funding level of the Dutch pension fund before accrued pensions (whether in payment or not) are required to be reduced. In the UK, there is a statutory prohibition (Section 67 of the Pensions Act 1995) on reducing accrued pension rights in an ongoing pension scheme as a result of a deficit shown in a valuation of the scheme.
  - 1.6 In the event of employer insolvency, in the UK, the beneficiary of the pension scheme will receive a minimum level of compensation from the Pension Protection Fund which, for a pension in payment, will result, where the pensioner has attained “normal pension age”<sup>50</sup> for Pension Protection Fund purposes, the reduction in the nominal level of benefit (but with a reduction or freeze on future pension increases – depending on the period over which the pension accrued).
  - 1.7 In the Netherlands, on the insolvency of the employer the nominal amount of the accrued pension (whether in payment or not) should not, in general, require any reduction (or any material reduction) because of the approach to funding of the pension scheme.
2. The “real life” experience of the Dutch CDC Scheme model and its “extreme stress test” following the 2008 financial crisis provides some valuable learning opportunities when designing a legal and regulatory framework for a CDC Scheme appropriate to the UK environment.
  3. The severe impact of the 2008 financial crises has raised issues over intergenerational fairness within the Netherlands. A UK CDC benefit design needs to have regard to those issues.
  4. However, an important point to draw out is that one aspect of the intergenerational fairness debate in the Netherlands is the starting assumption that the employer

---

<sup>50</sup> In summary, the earliest age the member can draw his or her benefits as of right (and without any reduction for early payment), ignoring special circumstances such as ill-health.

contributions seem the same (for example, 15% of pensionable pay) for a 25 year old as they are for a 55 year old.

5. A more accurate analysis is that the 15% rate, in our example, is an average rate derived from the different ages of the members of the pension scheme. So, for example, the cost for the 25 year old in respect of the accruing pension for the year in question may be no more than 5% of pensionable pay. In contrast, the cost of one year's pension accrual for the 55 year old might be 25% of pensionable pay.
6. A point on which clarity of analysis is needed in the UK is to avoid the conflation of:
  - ◆ an average contribution rate derived from the differing ages and costs of the benefits for the different active members,

into

  - ◆ the assumption that the rate would be a uniform 15% (in our example) for the 25 year old and the 55 year old if contributions were being paid to an individual defined contribution pension scheme.
7. In the UK it would be open to the employer (with the agreement, where applicable, of its recognised trade unions) to determine a benefit design where:
  - 7.1 the aim was to provide for 2 employees doing the same work for the same pay with the same target level of retirement income for the same year of employment<sup>51</sup>, or
  - 7.2 to provide, for the same employer contribution, different levels of target retirement income for 2 employees doing the same work but of different ages (reflecting the higher cost of purchasing that target retirement income for the older employee compared to the younger employee), or
  - 7.3 to have an individual defined contribution pension scheme where the same employer contribution was paid for the older and the younger employee on the same pay doing the same work in respect of the same year, but recognising that the younger employee should, all other things being equal, end up with a substantially larger retirement account available for conversion to retirement income for that year (or to be drawn as retirement income), all other things being equal, or
  - 7.4 to have an individual defined contribution pension scheme where higher employer contributions are paid for older employees than for younger employees on the same pay, doing the same work, in respect of the same year with the aim of providing the same level of retirement account on the employee attaining normal retirement age for the same year of employment, all other things being equal.

---

<sup>51</sup> Recognising that the older employee's target retirement income for that year will come into payment before the same year's target retirement income for the younger employee (but with the aim of preserving the purchasing power for those employees of that target retirement income in respect of that year).