Pension reforms in the Netherlands this millennium; from DB via CDC to DC?

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Topics of today

• Some typical characteristics of the Dutch pension system

• Evolution of the Dutch pension system from the start of this millennium until 2020

• Plans for reform as of 2020
The Dutch pension landscape

- Population 17 million
- Workforce: 7.5 million employees and 1.5 million entrepreneurs
- Three pillar system
  - State pension
  - Occupational pension
  - Private pensions

Future provisions

- State pension: 45%
- Occupational pension: 45%
- Private pension: 10%
System is not so bad...

Melbourne Mercer Global Pension Index 2017

The following table summarises the results.

<table>
<thead>
<tr>
<th>Grade</th>
<th>Index Value</th>
<th>Countries</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>&gt;80</td>
<td>Nil</td>
<td>A first class and robust retirement income system that delivers good benefits, is sustainable and has a high level of integrity.</td>
</tr>
<tr>
<td>B+</td>
<td>75–80</td>
<td>Denmark Netherlands</td>
<td>A system that has a sound structure, with many good features, but has some areas for improvement that differentiates it from an A-grade system.</td>
</tr>
<tr>
<td>B</td>
<td>65–75</td>
<td>Norway Finland Sweden Singapore Switzerland New Zealand Chile Canada Ireland</td>
<td></td>
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</tbody>
</table>
System is not so bad…

Allianz International Pension papers 2015/1

Figure 3: Retirement Income Adequacy (RIA) Ranking

- Netherlands
- Denmark
- Norway
- Switzerland
- Japan
- United States
- Austria
- Sweden
- Hungary
€ 2,500,000,000,000

1st pillar, unfunded, mandatory

2nd pillar, funded, semi mandatory

Over 200% of GDP

Source: CBS 2015/02, table 5.1.
1st pillar State pension

• Basic provision, not means tested
• State Old Age Pension Act:

  “every resident and every foreigner which is employed and hasn’t reached the age of retirement, has the duty to pay contributions, and is insured”

• Contribution 2018: 17.9% of € 33,994 = € 6,084 (max)
• Benefit ends with death or imprisonment
• Single pensioner: € 1,173 per month
• Married pensioner: € 808 per month
2nd pillar pension system in foundations

- Assets under Management in funds (excluding insurance companies) is over 200% of GDP
- 95% of employees participate (semi-mandatory)
- Number of pension funds (separate independent legal entities) declined from 1,000 (around year 2000) to around 300 currently
- Around 50 industry-wide funds
- Around 250 company funds
- Around 10 occupational funds
- Average retirement income (1st and 2nd pillar) € 19,800 per year
- EET-system
- Mainly average pay DB with conditional indexation and ‘fixed’ premium (CDC)
- Gradual trend towards iDC
Current average premium system
Evolution of Dutch pensions: main denominators

The Enron Affair
IFRS implemented
Financial crisis
Government regulations

Final salary
Average salary
Combination
Defined contribution
The Enron Affair

- Enron sponsored a retirement plan
- As of December 31, 2000, 62% of plan assets held in the corporation
- Shares of Enron where in January 2001 $80/share and dropped to $0.7/share
- The losses suffered by participants of the pension plan have prompted questions about the laws and regulations that govern these plans
- As a result IFRS / IAS19 was implemented. This had a huge impact on Dutch pension plans

Stock price Enron

<table>
<thead>
<tr>
<th>Date</th>
<th>Stock Price</th>
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<td>1-Mar</td>
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<td>20-Mar</td>
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<td>6-april</td>
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<td>26-april</td>
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<td>15-May</td>
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<td>4-June</td>
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<td>21-June</td>
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<td>11-July</td>
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<td>30-July</td>
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<td>16-Aug</td>
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<td>23-Nov</td>
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<td>12-Dec</td>
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</table>
Introduction of IFRS / IAS19

- **Pension commitments**
  - **Defined Contribution**
    - Premiums as an expense in the profit and loss account
    - No provision in the balance sheet
  - **Defined Benefit**
    - Provision in the balance sheet according to special calculation rules and market value

- **IAS 19**
Result: CDC was ‘invented’ to share risks

CDC in the Netherlands:

• A Defined Benefit average pay plan → DB from legal and communications point of view

• Total premium / contribution is fixed or capped as a percentage of total salary → DC for IFRS / IAS19

• Accrual rates can be adjusted when coming service cost changes

• Benefits must be cut when coverage ratio is below 105% for a longer period of time (and certain conditions are met)

• Indexation is always conditional (both for active participants and pensioners) and dependent on coverage ratio of the pension fund

• So why is it called CDC? → because Contribution for this DB plan is Defined on a Collective basis
Financial crisis

Crisis

Interest rates

Coverage ratio
Result: failures of intransparent system showed

- No indexation and benefits were cut: plan members realized that guarantees were non-existent. DC-plans somewhat more popular
- Legislator took action:

  - Accrual rates from 2.25% to 1.875%
  - Pensionable salary capped at € 100k
  - Market interest rates used
Risks moved towards plan members

Risk employee*

Final pay
- Additional payments
- Variable premium
- 70% final salary (backservice)

Average pay
- 70% of average salary
- Wage inflation and price inflation conditional

CDC
- Fixed premium
- Volatile accrual

DC
- Age-dependent Contribution ladder

* Interest, Return on investment and inflation
2020 reforms

Goals:

• Simpler and more transparent system
• Accommodate changes in labour market
• More flexibility
• Less undesired risk sharing
• No more average premium system
• Defined Benefit (thus also current CDC) no longer allowed; only DC (with intergenerational fairness)
• Uncertain what will happen
Summary

• IFRS, financial crisis and increasing life expectancy showed that the system is not perfect
• Risks shifted gradually to employees
• CDC was introduced in pension funds: a ‘soft’ DB plan
• Lack of transparency in ownership, little individual flexibility and unwanted redistribution between (groups) of plan members drive further changes as of 2020
• Is the end of the Dutch CDC system coming?