The Dutch 3-pillar pension scheme

Mercer  Global Pension Index 2017
The Dutch 3-pillar pension scheme

- Good points (according to Mercer):
  - Generosity of Dutch pensions
  - Coverage
The second pillar (collective supplementary pensions)

• Points to improve (the Dutch debate):
  • Communication policies of pension funds
  • Little flexibility
  • Wage-earners and self-employed persons
  • Intergenerational risk sharing and redistribution
Intergenerational risk sharing

• Collective pension schemes share risks:
  • Equity return risk
  • Interest rate risk
  • Inflation risk
  • Longevity risk
  • Labour productivity risk
Intergenerational risk sharing

• Risk sharing is welfare-increasing
  • Expected utility:
    • Coefficient of risk aversion
  • Prospect theory:
    • Degree of loss aversion
Intergenerational risk sharing

• Expected utility

• Prospect theory
Intergenerational risk sharing

- *Ex ante*, risk sharing is welfare-increasing
  - For all participating generations
- *Ex post*, it may be perceived as welfare-reducing
  - Again for all generations
Intergenerational risk sharing

- Is risk sharing really welfare-increasing?
  - Equity premium
  - Inflation risk premium
  - Country risk premium
Intergenerational risk sharing

• How do pension funds implement risk sharing?
  • Pension contributions
    • Employers
    • Workers
  • Cuts in the indexation of pensions
    • Pension benefits (retired)
    • Pension accruals (workers)
  • Funding ratio
Intergenerational risk sharing

- Before 2000
  - Pension contribution rate
    - 1/3 employee
    - 2/3 employer
  - Lumpsum payments by employers
## Collective pension funds in the Netherlands

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<tr>
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<tr>
<td>DB, final wage</td>
<td>66.5</td>
<td>3.2</td>
<td>0.2</td>
</tr>
<tr>
<td>DB, average wage</td>
<td>25.0</td>
<td>87.8</td>
<td>90.3</td>
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<tr>
<td>DC</td>
<td>0.5</td>
<td>4.7</td>
<td>7.0</td>
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Intergenerational risk sharing

- After 2000
  - Indexation cuts
  - Cuts in nominal pensions
- According to expected utility theory
  - The two are equivalent
- According to prospect theory
  - The two may be very different
• Smaller role for pension contributions
  • Intergenerational risk sharing ↓
• Bigger role for indexation cuts
  • Intergenerational risk sharing -
• Bigger role for funding ratio
  • Intergenerational risk sharing ↑
Collective pension funds in the Netherlands

Average funding ratio

2007Q1 2008Q1 2009Q1 2010Q1 2011Q1 2012Q1 2013Q1 2014Q1 2015Q1 2016Q1 2017Q1
Funding ratio

- “Balance” between
  - Shocks in life expectancy and interest rate
  - Indexation cuts
Loss of purchasing power

• 2007-2017, the Netherlands:
  • 5-6 percent loss due to indexation cuts
  • 2 percent loss due to nominal cuts
  • Total: 7-8 percent loss
• 2011-2017, ABP, the largest pension fund in the NLs:
  • 13 percent loss
Loss of purchasing power

- *Ex post*, intergenerational risk sharing may be perceived as welfare-reducing
  - By all generations
- Series of cuts in indexation and nominal pensions have led to an intergenerational conflict
  - The old: back to guaranteed pensions
  - The young: get rid of any guarantees
Coalition agreement

- Abolish uniformity pricing
- Move towards a system of individual pensions with a collective buffer
- Investigate the option of lumpsum take-ups at retirement
Abolish uniformity pricing

• Less redistribution between young and old workers
• Less distortion of the decision to become a wage earner or self-employed
• But: transition problem
  • How to compensate all working generations for their excess contributions?
A system of individual pensions with a collective buffer

- Every participant has his or her own account
  - Greater transparency
- Via the buffer, intergenerational risk sharing will be preserved
- Details unknown yet:
  - Buffer cannot be negative
  - Size buffer is limited
- Intergenerational risk sharing ↓
Lumpsum take-ups at retirement

- Investigate option to take up part of accrued pension wealth upon retirement
- The Netherlands are unique, together with Norway
- Greater amount of flexibility
- Take care of unwarranted take-ups
  - Limits to lumpsum amounts
  - Financial choice architecture
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