Global Pension Risk Survey 2019

The Netherlands Survey Findings

Enter

Introduction

Welcome to the 2019 Global Pension Risk Survey, covering the responses from the Netherlands.

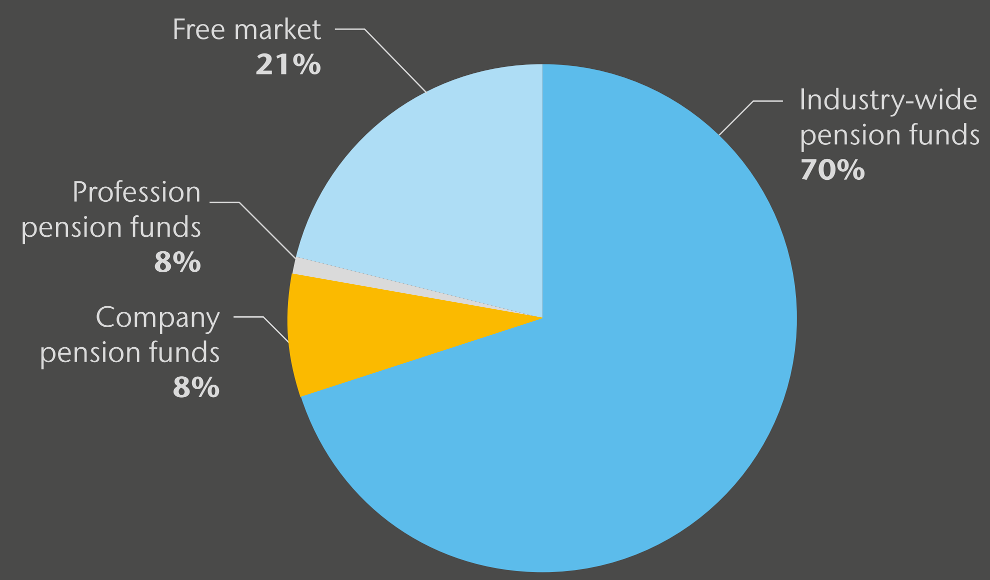
Aon carries out the Global Pension Risk Survey every two years, and looking back over the last decade, we can see how the pensions landscape has developed. Ten years ago, schemes were dealing with the fallout from the global financial crisis, and over the following years, increasing numbers of schemes restructured by, primarily, moving from a defined benefit plan design to a defined contribution plan design in response to increasing longevity and decreasing interest rates.

The outcome of this survey has to be seen in the context of the Dutch pension landscape, with its prevalence of industry-wide pension funds and its defined benefit promises, which are proving impossible to keep.

The current pension landscape is not sustainable, due to the increasing age of the population and current low interest rates. All pension funds are suffering from extreme low coverage ratios and, as a result are having to waive indexation and even cut the pension benefits they offer.

In the free market, the most prevalent pension plans are insured plans with a defined contribution plan design.

Market distribution in the Netherlands



Note: These results are based on the Assets under Management

A Pension Agreement

between the government, labour unions and employers' organisations was reached in June 2019.

Background to the new Pension Agreement

- Agreement between social parties in industry
- Increasing retirement age has been approved by the government
- Trend: voluntary pension contributions
- Insured solutions increase
- Rise of providers:
  - Premium Pension Institute (PPI) for DC
  - General Pension Fund (APF) for DB

Key findings

Growing trend towards **funding for self-sufficiency** as long-term target

Average timescale to reach long-term targets is about **13 years**

Approx **13 years**

About 40% expect to reach long-term targets within ten years

67% plan to rely on **asset performance** to reach targets

The new Pension Agreement

A principle Pension Agreement between the government, labour unions and employers' organisations was reached in June 2019.

After almost ten years of negotiations, the unions, employers and employees, and politicians have closed a deal on the future of pensions in the Netherlands.

Does this mean that pensions will not be cut anymore? What will the future bring?

In recent years, the resistance to existing pension policy has been growing. Dutch pensions found themselves in a difficult situation due to low interest rates and the high solvency requirements they faced. Pensioners in the industry-wide pension funds, 7.5 million citizens in total, have been negatively affected by the actual financing rules. In tandem, Dutch pensions face issues like increasing retirement age, especially for manual workers and others and the lack of pensions for the self-employed.

What is changing?

The state retirement age will be frozen

The state retirement age will be frozen in 2020 and 2021 at 66 years and four months. After that, retirement age will increase in stages to 67 years in 2024. The link to life expectancy will be partially waived; for instance, in the event of a one-year increase in life expectancy, the retirement age would increase by only eight months.

Early retirement

Employers will have the opportunity, temporarily for a period of five years, to pre-retire their employees for three years in a fiscally advantageous way. The change in rules is designed particularly for lower-paid employees.

Pension for the self-employed

The self-employed will not be obliged to accrue retirement pensions. However, they will be empowered to do so. At the same time the self-employed will be obliged to take out disability insurance.

Lump sum at retirement date

At retirement age, a maximum of 10% of the capital accrued can be taken as a lump sum for certain purposes, like mortgages, healthcare costs or a holiday. These new rules apply for both second pillar (employer-sponsored) and third pillar (individual savings) pensions.

Changing the average premium system

The average premium method will be abolished. This will be the case for all types of pension plans, either in a pension fund or an insured plan, and will mean that an age-independent premium will be the norm. Pensions will not be accrued on the basis of age. This is known as a 'degressive accrual', and is designed to ensure that age groups will not subsidise each other's pensions.

It may be that for certain groups of existing employees who change pension system mid-career, the unions or works councils may ask for compensation from the employer to the employee. Where employers need to change to a new pension system, a transition plan will be required; Aon is well placed to help employers with these plans.

Two new pension contracts

Under the new pension agreement, two new types of pension contracts are introduced. The first type is a defined contribution plan as exists currently. In this contract, the risks are collectively shared only in the pay-out phase when an annuity is bought.

The second type of contract is also a defined contribution plan, but one in which the risks in the accrual phase are also collectively shared. Targeted coverage ratio is set at 100%. Volatility may be spread over ten years and can be shared among existing and future participants.

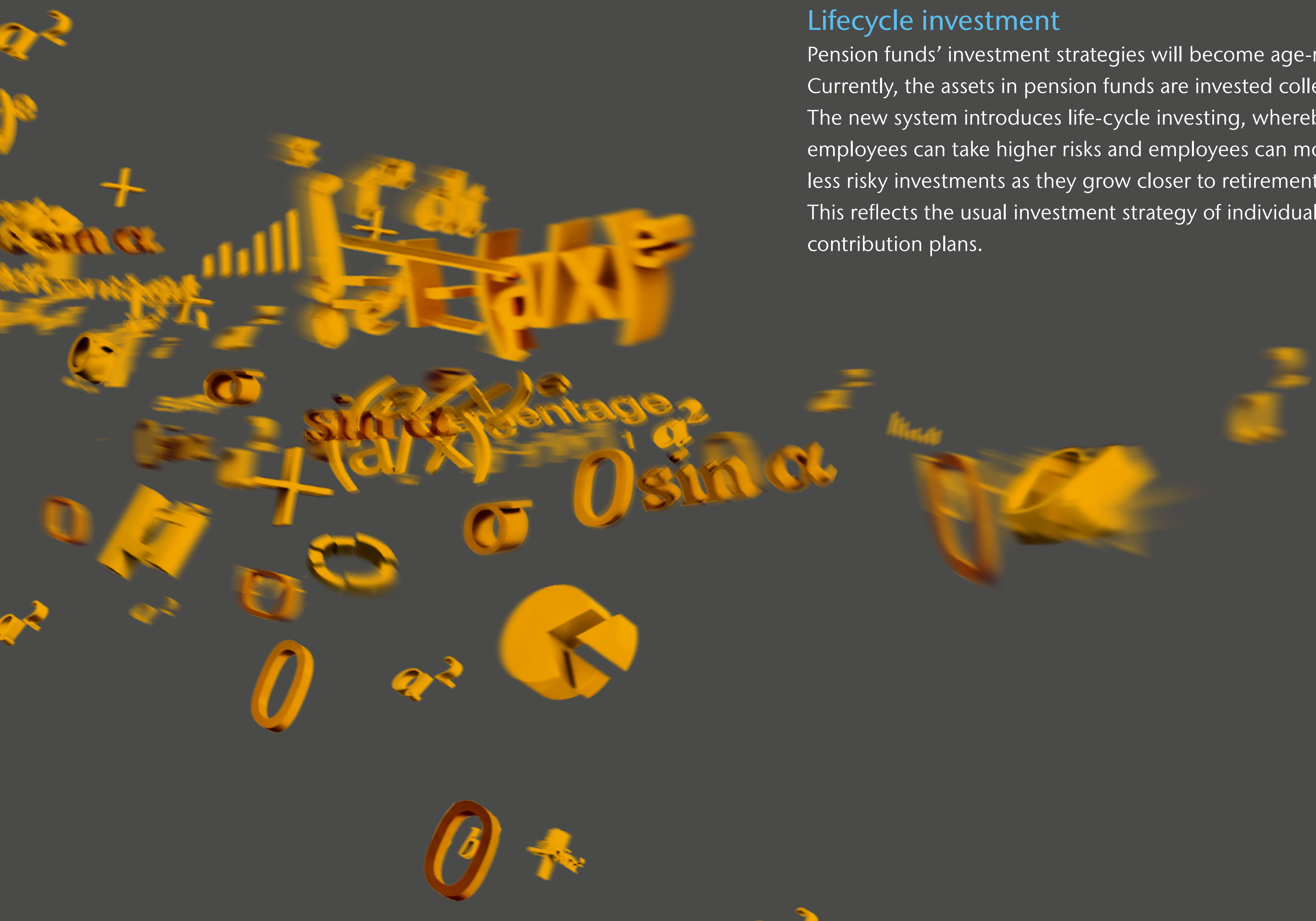
It is up to the unions and work councils to decide the way they will manage the collective risk sharing.

Value transfer to the new system

It will be possible to transfer pension rights to one of the two proposed new systems. A new financing framework will be developed to transfer the assets to the new system. The unions or works councils will have the final decision to transfer or not to transfer the rights.

Lifecycle investment

Pension funds' investment strategies will become age-related. Currently, the assets in pension funds are invested collectively. The new system introduces life-cycle investing, whereby young employees can take higher risks and employees can move to less risky investments as they grow closer to retirement age. This reflects the usual investment strategy of individual defined contribution plans.



Reducing / removing the need to cut benefits

In the new pension system, a 100% coverage ratio is the standard. Pension funds are already moving to mirror this, in anticipation of the new rules. On this basis, in many cases pension funds will not need to cut the benefits they provide, whereas if they had applied the present financing framework, they would have had to.

Next steps

On 2 July, the Senate approved the slower increase of the state retirement age. The intention is that the complete New Pension Law will be effective from 1 January 2020. The Dutch Cabinet intends that the legal framework of the new pension system will be ready from 1 January 2022. Meanwhile, the pension system is moving gradually to the new framework detailed above.

Examining pensions in the Netherlands compared to the rest of the world

As the Netherlands is not unique, the remainder of this report sets out how Dutch schemes are, in general, positioned in comparison to the rest of the world, using data from the other countries represented in the 2019 Global Pension Risk Survey.

Funding targets

When pension schemes and their trustees were asked about their long-term targets, the most common long-term targets shown across the survey are:

1. No long-term objective (as yet)
2. 'Strong' self-sufficiency / minimal risk

There has been a growing trend globally towards funding for self-sufficiency, defined in the survey as running a scheme with a largely risk-free investment strategy. We are seeing a consistent trend in the Netherlands of schemes targeting a self-sufficiency basis, and this is particularly true for the larger mature and maturing schemes. This trend is reinforced by the stringent rulings of the DNB (Dutch National Bank) as the regulatory authority.

Achieving long-term targets

About 40% of schemes across the survey expect to reach long-term targets within ten years.

Schemes are looking to investment returns which outperform discount rates over time to help them meet these long-term targets. Risk management exercises are also expected to play a significant role, while increases in contributions beyond rates set out in funding proposals are also expected to be a feature.

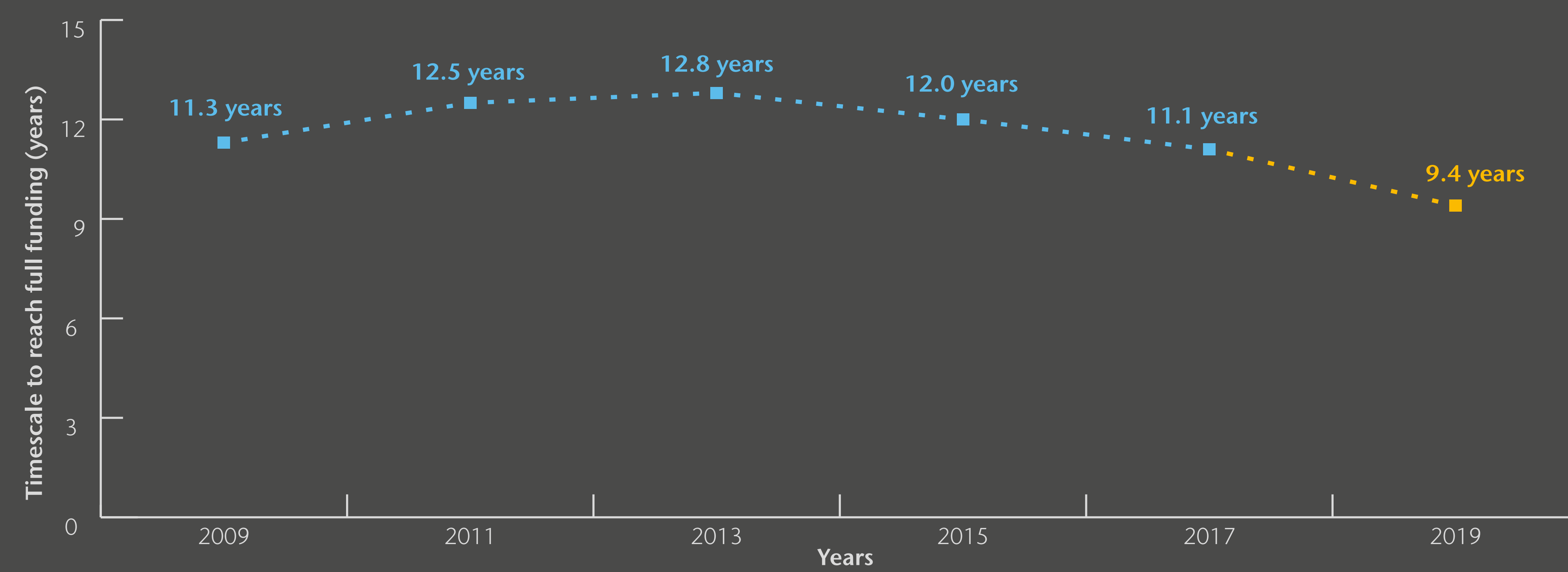
Timescales

The average timescale for schemes in the Netherlands to reach their long-term targets is about 13 years. This is a little longer than in some other countries, for example in the UK, where it is now less than 10 years.

The graph to the right shows the expected time to achieve long-term targets from the UK section of our survey; the shape is broadly representative of what we are seeing in the Netherlands. As funding levels deteriorated after the last economic crisis, timescales increased as longer funding proposal periods were put in place. Over time, as funding levels and more robust plans have been agreed between companies and trustees, expected timescales have generally decreased.

Since the survey was carried out before the summer, the rate of decrease has slowed, mainly due to headwinds such as the low bond yield environment prevailing in the Eurozone.

Timescale in the UK for schemes to reach long-term target as reported in previous Global Pension Risk Surveys



Investment strategies

- 67% of schemes plan to rely on asset performance to reach targets
- More than 50% of schemes have a robust flightplan to reach their long-term target

Schemes in the Netherlands and across the world continue to reduce their exposure to equity markets, while increasing investments in matching assets such as fixed interest and index-linked bonds. We are also seeing increased investment in illiquid assets, such as infrastructure funds, over the last two years. Schemes have reported that they will continue to look to de-risk out of equities and into matching assets, with some appetite also visible for further illiquid assets.

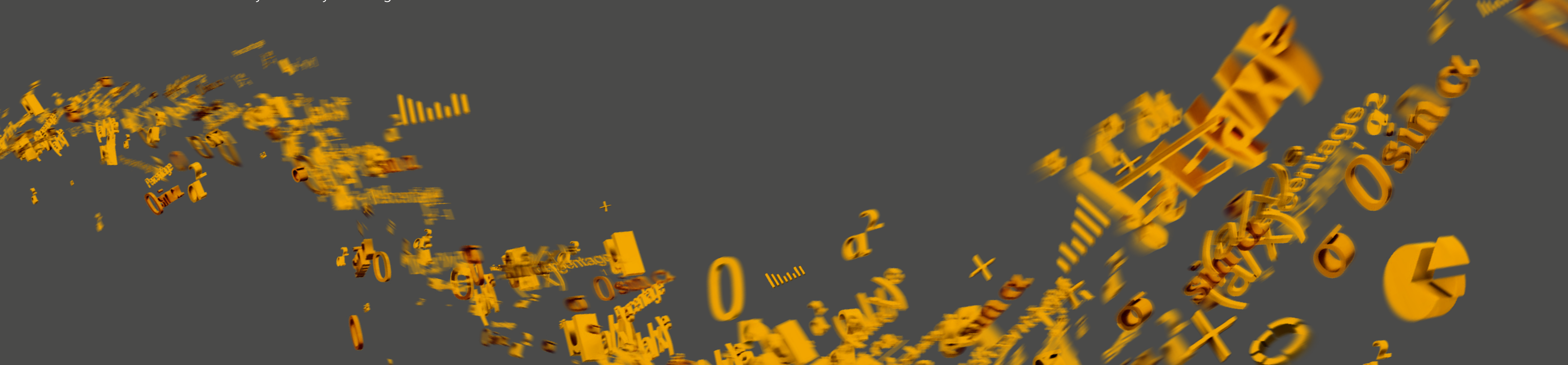
General sentiment towards equity markets and the economy in general, along with an increased focus on hedging liability risk, have also led schemes to further diversify out of equities and into LDI-type assets and illiquid assets. Within equity strategies, we see an increasing number of schemes broaden their equity mandates to include factor investing. Diversified growth/absolute return funds also remain while diversified growth/absolute return funds remain popular, although perhaps as part of a fund-of-funds solution rather than by exposure to single managers.

We are also seeing evidence that some schemes globally are not investing in ESG (environmental, social and corporate governance) assets and green bonds. Pension funds in the Netherlands are taking a pioneering position in this respect. The market for green assets and bonds is slowly but surely maturing.

Impact of IORP II

The impact of legislative changes such as the IORP II directive may lead some schemes to explore outsourcing more work to third-party providers. The requirement to have specific key function holders such as internal audit and risk management will increase governance costs, while ‘fit and proper’ requirements on trustees are likely to increase opportunities for professional trustees.

The requirement for schemes to consider ESG factors as part of investment strategy discussions will also increase. The full impact of IORP II is yet to be seen and will depend on the exact implementation of this EU directive in the Netherlands.



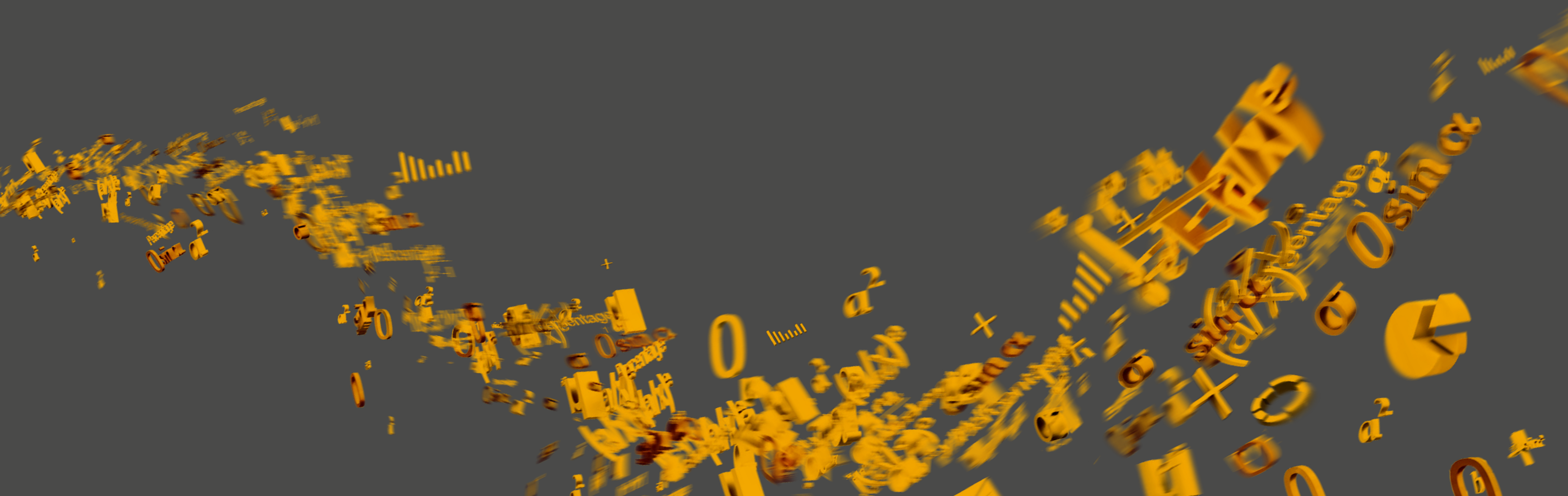
Conclusion

The environment for pension schemes within the Netherlands continues to evolve. Over the past two years, since our last survey, we have seen schemes starting to drop below the requested coverage ratio for indexation; furthermore, some large schemes' risk increased to the level at which they are obliged to cut pension benefits. The DNB is getting stricter on smaller pension funds, where cost levels are high and coverage ratios historically low. These funds are looking at merging, or joining a multi-employer pension fund (Voluntary Industry wide Pension Funds (BPF) and General Pension funds (APF)) or looking for an insured solution.

The funding discount rates that are driving the cuts in pension benefits are creating renewed interest in transferring to cross-border plans in countries where pension cuts are not possible, and can be supported by reserves built up rather than employer contributions.

The new pension legislation, which will be fully implemented from 2022, casts its shadow ahead. As a result, all pension funds are looking at alternative financing methods, similar to a defined contribution approach with collective risk sharing. Lifecycle investing will become the default investment approach.

In the coming years, the defined benefit approach will slowly but surely disappear from the Dutch pension market. The transfer of the assets from one system to the other will remain one of the largest challenges in the evolving Dutch pension landscape.



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