IPE, March 2017

Pensioen Federatie: From models to reality

***Richard Pauw** assesses the debate on pension reform in the Netherlands*

The Dutch pension system is still considered one of the best and has a high position in numerous international rankings. Nevertheless, changes in the Dutch labour market and demographics, combined with low interest rates and volatile financial markets, are forcing us to innovate. The Federation of Dutch Pension Funds (Pensioen Federatie, PF) wants to play a proactive role in modernising the system. There are great challenges and changes ahead, but we should concentrate on fixing what is really broken.

Collectivity, risk sharing and mandatory participation are interrelated and important pillars for our future system. The Social and Economic Council (SER) and the social partners are leading in the development of a new pension contract that should co-exist with current schemes. Two prototypes developed by the SER are promising. The SER and the social partners can use the expertise of the PF and its members by 'applying' the prototypes to the real world and real pension funds. The outcomes of our own analysis are interesting and useful.

Key drivers of change

The low interest rate environment, extreme monetary policy and volatile financial markets place financial pressure on pension funds. Plummeting coverage ratios have led to a debate about who will pay the price in the case of deficits. Pensioners as well as younger generations feel robbed, but both cannot be right. However, this discussion illustrates that we have great difficulty explaining our current system and its payout agreements to the public. Assets have never been higher, but there is no room for indexation and there is a threat of pension cuts. Most people simply do not understand why, and who can blame them?

The PF looks forward to the introduction of a new type of scheme – a contract that is less vulnerable to interest rate fluctuations, improves the chance of indexed pensions and enables us to share risks while being more comprehensible. Such a solution may be close.

Careers as volatile as the markets

About 90% of all Dutch employees have a supplementary pension as a result of mandatory participation. However, the numbers of self-employed has exploded over the last decade and most of this group does not save enough for retirement. This is one of the reasons for the differences between households when it comes to pension adequacy.

Political preferences on what to do with the self-employed differ. About half of the political parties want to oblige the self-employed to accrue pensions. The other half perceives the self-employed as entrepreneurs who should not be forced to do anything. There is one thing that all parties agree on – improving access to supplementary pensions is of the utmost importance if we want to enable everyone to maintain their standard of living after retirement.

A further reason for reform is the flexibilisation of the labour market. Working for one employer over a lifetime has become a rare phenomenon. Temporary jobs and job hopping are now much more common. Although there is a renewed call for more fixed contracts, it is unlikely many people will work for one employer for their entire career.

Prototypes successfully tested

The SER presented extensive reports on new pension contracts in spring 2016. Two variants seem promising and were adopted in a government paper. In July 2016, it was concluded that two prototypes have potential and need to be explored:

· Variant 1: a payout agreement with degressive accumulation of pension rights, which is less vulnerable to changes in interest rates;

· Variant 2: personal pension capital with collective risk sharing.

The PF put both prototypes to the test later in 2016, and presented reports in November concerning financial outcomes, legal consequences, communication, and eventual execution and implementation. Our legal analysis shows that a system with degressive accumulation causes issues concerning age discrimination.

However, in general the results are positive. Both variants are workable and can be further optimised by the SER. Meanwhile, both the Bureau for Economic Policy Analysis (CPB) and the research network Netspar conclude that intergenerational risk sharing leads to greater economic welfare. Therefore, there are grounds to be optimistic about a new contract.

Prerequisites for success

The introduction of a new contract is not a standalone issue and can only be successful if it is combined with several prerequisites:

· Mandatory participation remains essential to keep collectives together and maintain risk sharing. It also prevents competition on labour conditions and contributes to low costs.

· A new fiscal framework. We are in favour of a simple framework that does not discriminate between employees and the self-employed. It is vital to keep pace with current fiscal developments. Recent government cutbacks on pensions have been radical. The Netherlands has an EET (exempt, exempt, taxed) system, but the fiscal allowance for pension accrual has diminished, making it harder to maintain living standards after retirement.

It is also important that the design of a new fiscal framework does not influence the choice of social partners for a particular scheme.

Responsible freedom of choice

The PF sees opportunities for more freedom of choice. Many schemes already offer the possibility to retire earlier or later and to exchange between a partner's pension or retirement pension. People can also opt for a high/low variation – they might prefer to have a higher income during their first years of retirement. Then they receive a temporarily higher pension than their 'default' pension as from their retirement date. The pension will then, of course, be lower than the 'default' pension after the agreed period.

We believe that it is possible to introduce a new type of choice – a one-off payment based on the high/low variation. The amount of money that represents the 'high phase' is then paid at retirement age, and the majority of pension is used for the (lower) life-long structural payments.

The introduction of such a choice would not affect adequacy according to current standards, as structural payments in the low phase remain untouched. At the same time, such a solution enables people to make better choices based on need.

Most people are able to evaluate their financial position at retirement age and make responsible choices. But we know from financial behavioural analysis that financial choices are not always made rationally. This is one reason why we are not in favour of the alternative use of pension premiums during accrual.

Speed up carefully

We are optimistic about the new contract and greater flexibility. This year will definitely be an exciting one. The new government – resulting from March's election – will play an important role, although we have to be realistic about the timeframe.

We should soon know the design of the new contract. The parliamentary process will take time, social partners need to agree on a pension deal and funds need to ensure the implementation. The process will take several years.

Only a fair and cautious transition to a new contract will secure public support. The transition needs to be transparent and well balanced, and all generations should receive their fair due. Pensions form an important source of income for pensioners and survivors. Social partners, pension funds and the government should maintain the initiative but refrain from driving recklessly.

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