The Dutch DB to DC-transition

– what can the Dutch learn from the Swedes and the Danes?

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Introduction

I am here to talk to you on the possible messages you may take from the Danes and the Swedes when you undertake the expected transition to DC.

The main message will be that "life in the DC world" is different from the one you know. It is not a bad life or even a worse life; but it is different.

I will start out by offering a quick look the main differences and similarities between the three countries and their pension systems.

Commonalities first.

We are **fortunate**. We are relatively **rich**, we are **well organized**, and we belong to the **global pension's elite**, if you will.

All three countries are **mature welfare states**, and we understand the **need to combine** strong public and private efforts.

Looking to our private schemes, we understand the importance of building **strong collective platforms** from which to provide individual arrangements.

We share a strong **capacity for change and adaptation**. We are not where they were 50, 25 or even 10 years ago. Things change, we learn, we become wiser, and we adapt.

I am sure you will share my feeling: Considering values and approaches, we are indeed family!!

Looking to the technicalities.

You are embarking on a complex transition from DB, via DA to DC. When you do that, there are good reason for you to look to the North and consider Danish and Swedish experiences.

1. **Denmark** has been operating 2nd pillar DC insurance schemes for more than half a century – in fact it never really had DB schemes.
   Instead, it applied guarantees leading to predicaments similar to the ones you are trying to tackle. Recent Danish reform measures in that area will be of interest to you.
2. **Sweden** is in a lengthy DB to DC transition for its supplementary occupational arrangements. Sweden is moving towards DC insurance not to different from the Danish approach.

When you look at the Nordic experiences and consider "life in a DC world", you will realise that it is a significantly different life.

It is not a worse life, but is different, from the one you know.

Also, you will see, that there will be "some steep hills to climb" – some of which you may not see clearly beforehand.

The DC world is a different place

But what is the big deal here, what are the **main differences** between DB and DC?

I will point to two aspects:

1. In a DC-world **each generation funds its own pension rights**. You cannot redistribute between generation to address challenges.
2. In a DC-world, **pension fund succes benefit participants**, and participants only. Similarly, less fortunate results or new constraints affect participants, and participants only.

In classic DB the individual is given a benefit related to previous career and wage. In principle, the contribution - or rather employer's pension expenditure – pension fund performance, pension management costs etc. are employer concerns only.

They are not really relevant to the individual.

This changed somewhat when you shifted to DA a few years ago – however DA does not create a direct relationship between contributions and benefits at individual level.

You are still behind on transparency.

These relationships change completely in a DC world. It is all about contributions, investment performance, pension management costs, and outcome – at individual level, that is!!

There is **no sponsor of last resort** to bail you out, if things go wrong. Pension contributions are set as part of wage agreements, employer pension expenditure is fixed, and employers are free of any future liability once the contribution is paid.

Similarly, any talk of "contribution holidays" or recovery periods is plain gibberish.

DC schemes are not immune to increasing longevity, low interest rates, market volatility etc. However, these challenges can only be addressed through regulation, better pension management, less generous guarantees or no guarantees, pension age indexation, and/or higher contributions.

Hence, on the structural side **two recent trends stand out** in Denmark and Sweden.

1. In both Denmark and Sweden (for lower income) **pension expenditure as a fraction of total wage costs have been increased** in recent years.
   However, as this is done through wage agreements, it has not affected total labour costs.
2. To address financial chalenges, the **use of guarantees has changed.** Guarantees are either restructured, lowered, or they are abandoned all together.

DC drives a strong individualisation

Individuality is a key aspect of DC.

In a DC context, **outcome depends on the pot available** at retirement. Therefore, participants' primary interests focus on contributions, costs, investments, risks, and performance.

In this sense DC drives a strong and immediate individualization of Social Security.

"What you pay and what you get".

You can share risks if they are insurable, but you cannot accommodate social redistribution or other non-insurable solidarities.

Consequently, one of your **"beloved babies"** – intergenerational solidarity – is up for review. Essentially in a DC context, each generation pays for itself and its insurances. You cannot systematically redistribute between or within generations.

Consider the flip side of this. One of your current challenges relate to intergenerational equity and the suspicion among younger generations, that intergenerational solidarity is but a one-way street.

This difficult - but important – credibility challenge dissolves in the DC context. This is a huge political gain!

Should you regret, the loss of your traditional intergenerational solidarity?

I think not. But of course, you will have to think about its absence when you design your DC products.

Risk mitigation and risk management will wear a new dress.

DC individualizes risk, and then…

"DB shifts risk to the participants!", it is often said.

Consider this statement for a second. Isn't that the case in all systems – unless of course your sponsor has very deep pockets?? Arguably, this is the main point of the recent transition from DB to DA.

The unsustainable will eventually break.

But how do you address this challenge in the DC context?

This is a huge discussion, where different techniques – for example life-cycle approaches, product innovation and combinations of different types of products – play a key role.

The bottom line – looking to the Danish and Swedish experience – is that the challenge can be addressed, and that the answer can be a strong one. Also, you will see that solutions may vary between segments.

You may notice, that neither Danes nor Swedes are worried sick about their pensions.

“Uncertainty is increasing!” you may say.

Yes, that may be so, but don’t exaggerate this point.

You can decrease risks as retirement approaches, they are mitigated by the coexistence with public systems, you can combine different types of products, and you can think of other design measures smoothing outcomes without systematic redistribution.

Risk mitigation is readily possible in a DC world.

Consider the alternative: Risk elimination.

The costs are indirect but unbearable: Taking out marginal risk will come at the cost of systematically lower returns and poorer outcomes for all and always.

And you will need higher contribution rates to achieve particular outcomes.

Transparency will become increasingly important

One of the steeper hills, you will have to climb, is the **changing mindset accompanying DC**.

DC comes with a legitimate pressure for transparency including individual information on admin costs, investment costs, returns etc.

You may be hard pressed to understand how far and how deep this will go.

The **Danish example** may be telling in this regard.

When funded DC scheme coverage was increased during the 90ies, it immediately drove a stronger political focus on transparency and individuality.

Confronted with these pressures – and after a lengthy wake up - the Danish industry adopted a **comprehensive transparency strategy**. This strategy includes cost measures at individual level, and – most importantly - it includes accounting for indirect costs.

Now most participants will not care. Individual information and behaviour will not drive competition in markets for complex financial products. Neither will financial education.

What matters is to ensure effective industrial competition. Enhanced transparency play a key role in this respect.

The Danish example is clear: Transparency and the ability of peers to look over each other’s shoulder strengthens industrial competition in an area where consumer driven competition is absent.

In that sense, providers are under constant evaluation.

Increased transparency has strengthened and improved industrial competition for the benefit of participants!

This has happened in a market where consumers cannot choose their own pension company.

Calls for increased individual choice will climb the agenda

On that note, another steep hill to climb relates to choice.

You will be facing calls for more individual choice.

Learning from peers, this can relate for example to own contributions, insurance coverages, investment profiles, and choice of pension products.

Policies however can be more or less successful.

On the less successful side, you may **consider the example of investment profiles**:

During the 90'ies many Swedish and Danish funds allowed participants to choose their own investment profile.

The belief was that large segments – over time possibly the majority of participants – would buy into these new options.

This naive expectation was not met – far from it actually.

The Swedes even overdid it in their public Premium Pension – 800+ funds to choose from is quite a mouthful.

Paradoxically - too much choice - becomes a barrier to choice.

Does this mean, that these initiatives are wasted and in vain?

Certainly not. For those who use these options they are important, and they protect the systems from being accused of applying an unmodern, inflexible one-size-fits-all approach.

The notion that choice is possible, is important – even to those who would never dream of using it.

Default solutions must be the key priority

The Swedish case underlines a basic message: In a Kierkegaardian sense you must meet people as they are and where they are.

Most people will have better things to do, they will not understand the issues, they are frightened etc. etc.

In effect they will want to stay with the default.

This in turn leads to the obvious guiding value statement:

- While choice is important, making an own choice must not become a precondition for an attractive outcome.

If you do not meet this benchmark, you are failing your participants.

Therefore, the design of default solutions become the most important issue of all for those who are bestowed with the responsibility to look after participants' interests.

In fact, default solutions should be relevant choice options even for pension professionals.

"Multipillarism" requires a holistic perspective

The Dutch DB to DA to DC transition is an important step – and a healthy one.

It raises **dilemmas and questions around the qualities and dangers of the new DC world.**

In wrapping up, my final point will be that you should be careful not to discuss these aspects by themselves or in themselves only.

Public and private pensions are complementary.

They are formed to address particular overlapping but not identical objectives and tasks.

However, when thinking about this, the risks, the opportunities,…. etc. policies must (also) be assessed in the context of the totality.

A changed approach to 2nd pillar pensions can – and probably will - raise questions as regards the distribution of responsibilities between public and private pensions and the design of the AOW.

You may note, that the Danes have been down that road only recently.

And you may note that the issue is currently climbing the Swedish policy agenda.

Who knows how this will unfold in the Netherlands?

Thank you for your attention.