Reforming Dutch sector wide pensions plans

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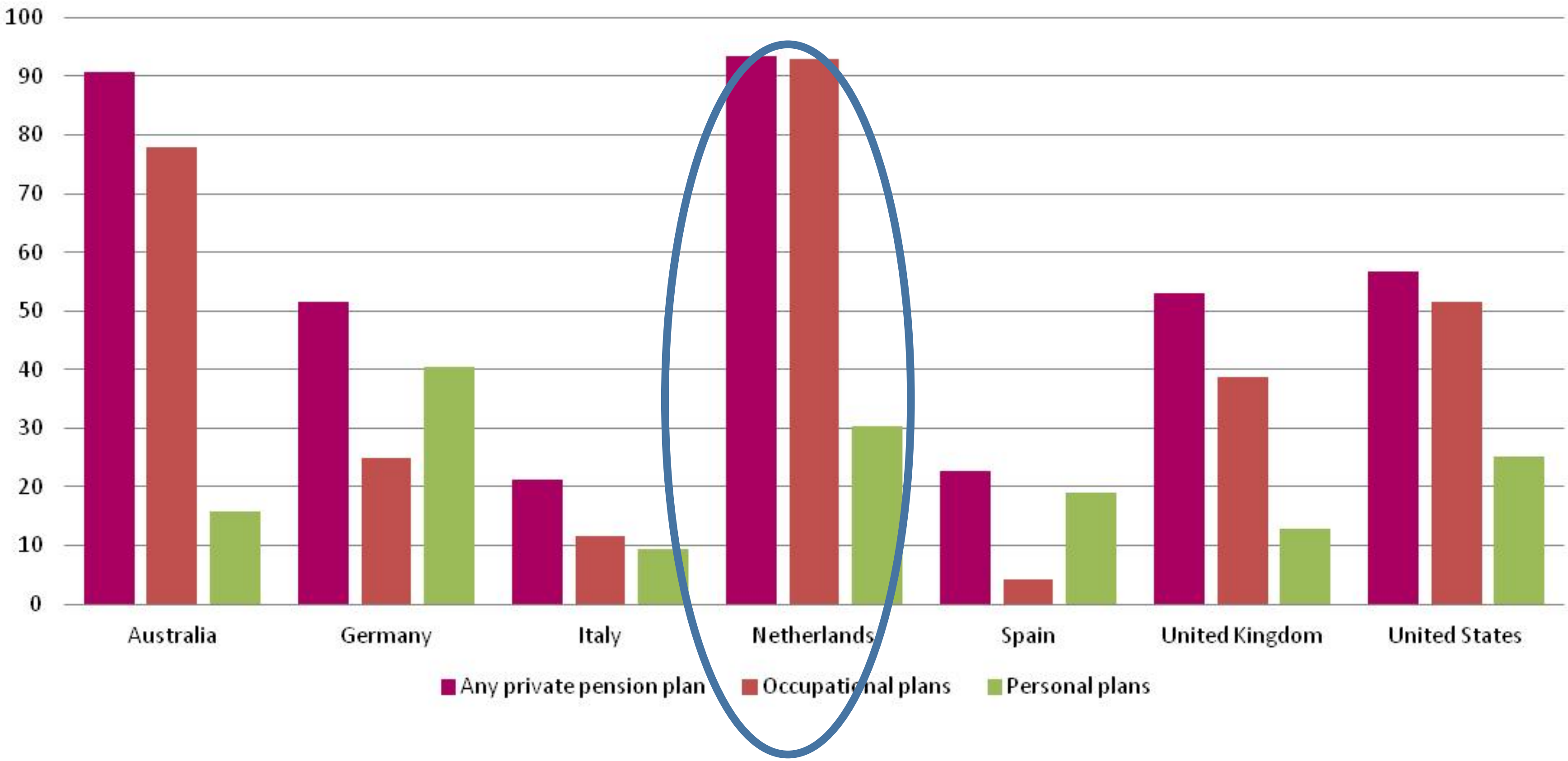
1. An extremely brief introduction to the Dutch pension system

- **Three pillars**: state (PAYG), supplementary pension funds (funded), individual: life insurance and annuities.
- **First pillar**: resident based lump-sum payment. Above minimum: very low poverty among elderly.
- **Second** pillar: fully funded (assets 1000 mln euro 150 % GDP)
- Integration of first and second pillar: **ambition level 70%.**
- **Very high level of participation** private pensions (pensions are part of labour contracts; collective labour contracts can be extented by law to cover whole sectors).
- Relatively **low costs**.
- **Protection against behavioral biases**.

Very high level of participation



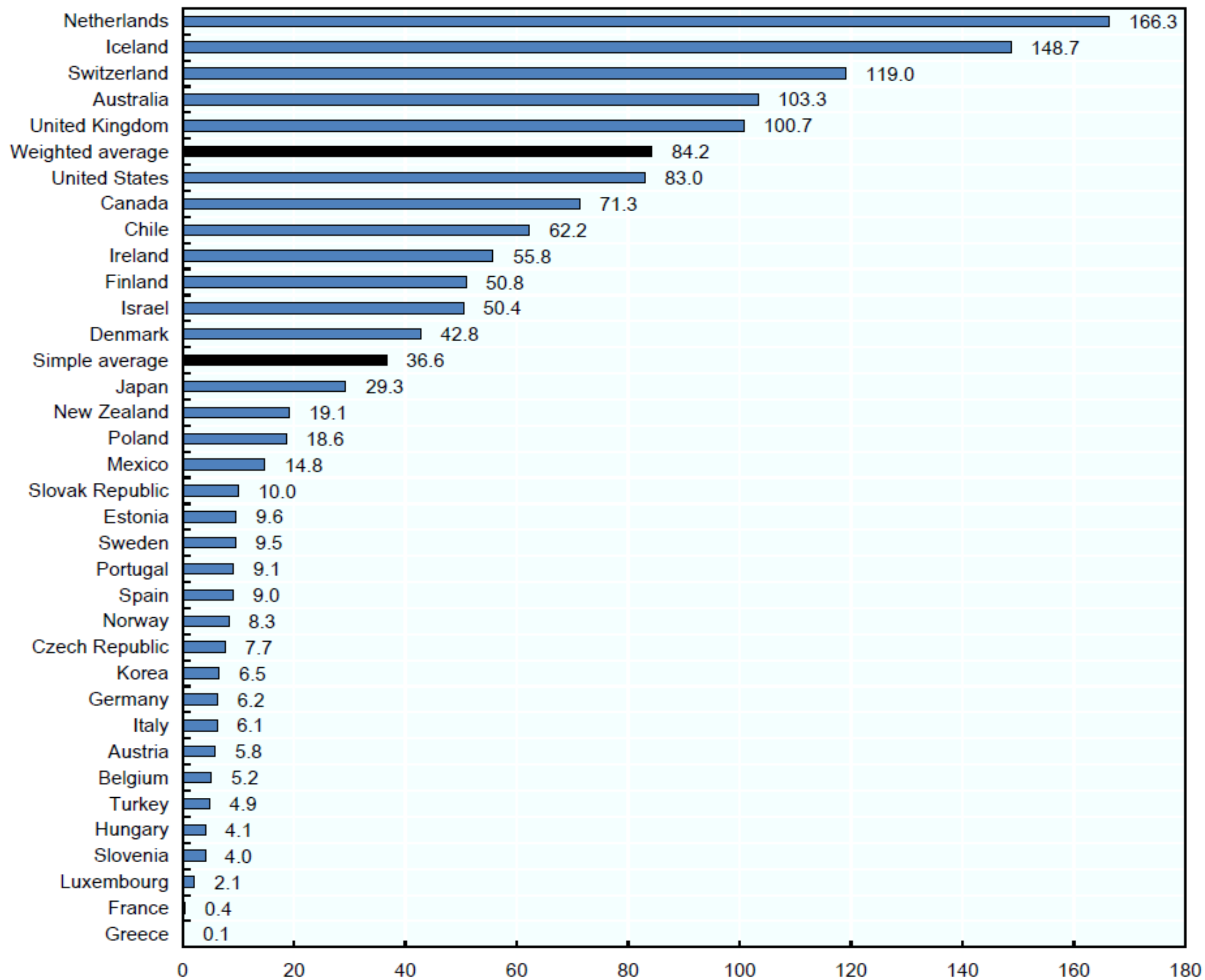
Source: Netspar (C. van Ewijk)

Focus: on three essential features supplementary pensions:

- Dominance of **industry wide funds** (mandatory participation in absence of company pension fund).
- These are **hybrid DB plans**.
- And are j**ointly managed by social partners** in independent trusts.

Figure 3. Importance of pension funds relative to the size of the economy in the OECD, 2013

As a percentage of GDP



Source: OECD

DB character private pensions special for the Netherlands

	Denmark	France	Germany	Italy	Nether-lands	Poland	Spain	Sweden	Switzer-land	United Kingdom
Public (non-contributory)	basic				basic					basic
Public (contributory)		DB points	points	NDC		NDC	DB	NDC	DB	DB
Private (mandatory)	DC				DB	DC		DC	DB DC	
Private (voluntary)										DB DC

Source: Netspar (C. van Ewijk)

General direction reform sector wide pensions

2003

Final salary DB → Average salary DB hybrid

[2010/2011: failed attempt real hybrid DB]

20??

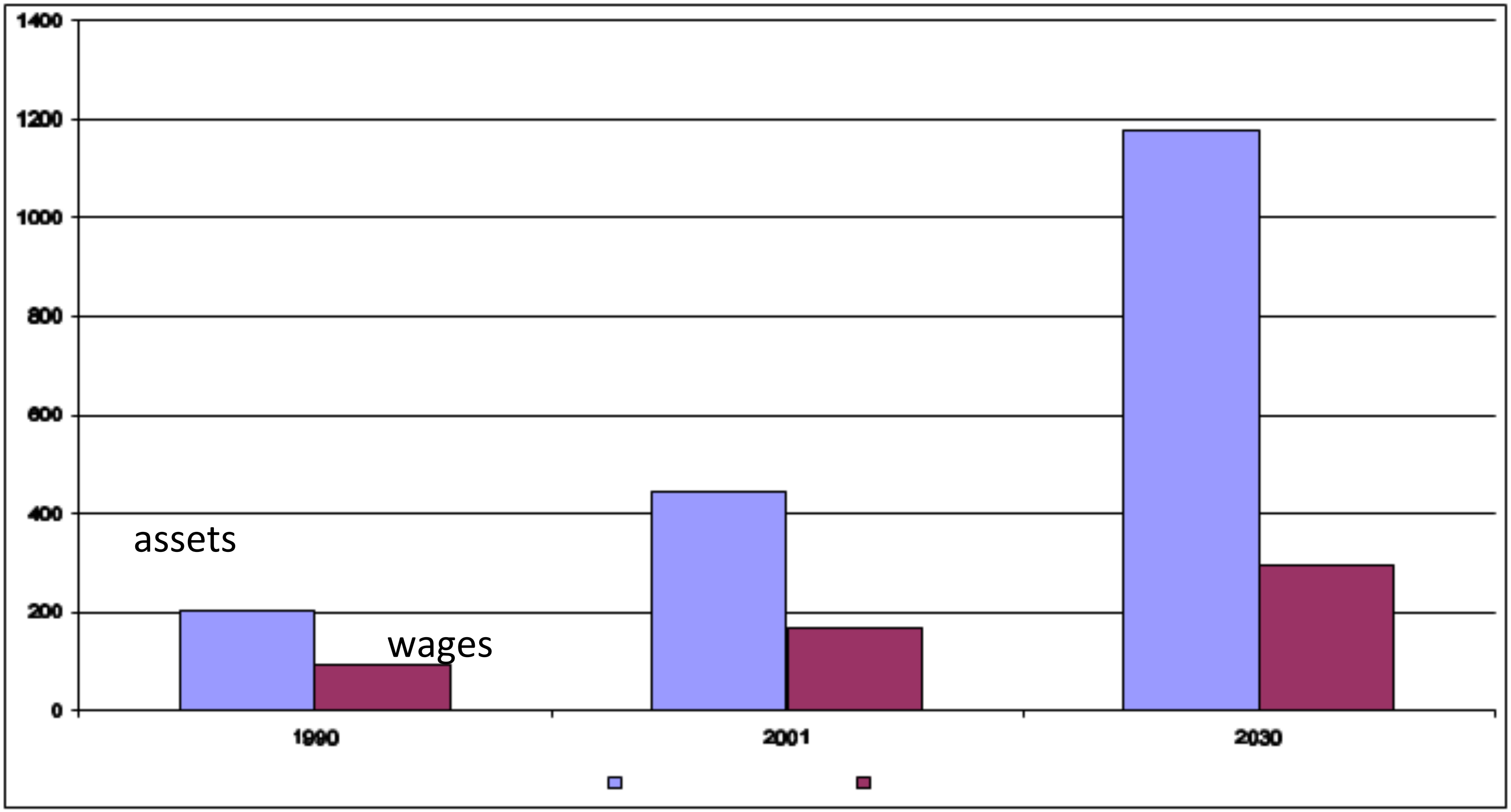
→ DC hybrid (DC + collective risk sharing)

Main challenge: how to bring expectations, plans, and supervisory framework (DB) in line with practices (CDC)? Participants are the main risk bearers.

Reform proces backgrounds

- Because of ageing and maturity and funds recovery contributions become less effective. Large rises in contributions (total 30 billion euro) are required to contain fluctuations in liabilities (total 1000 billion euro).
- Shocks in pension assets (2001-2, 2008-9).
- More recent: very low nominal interest rate increase the value of nominal pension liabilities and highlight incomplete ownership.
- Avoiding strong pro-cyclical macro-economic effects of pension system.

Pension assets and wages (mln euro's)



Why did the pension agreement of 2010/11 fail?

- ***Top down approach***. Caused almost a split in the main trade union federation (FNV).
- ***Insufficient communication of the 2003-switch*** (people still believed in guarantees, accusation of ‘casino pensions’). 2003-switch and 2010-1 were too complicated to understand and poorly communicated.

Why did the pension agreement of 2010/11 fail?

- ***Too much reliance on politics*.**
- Government was not part of the deal but was supposed to raise first pillar pensions.
- And was supposed to regulate change over to new contract and resolve the distribution of current and future pension liabilities.
- Current supervisory framework (December 2014) preserves DB character and aims to strike a generational deal but is much to complicated and is inconsistent. Nobody is happy now.

SER advisory report on the future of pensions (01/24/2015)

- **Joint diagnoses** of challenges
- Preference for **individual pension pots with collective risk sharing**. (farewell to DB).
- Implies **abolishing average pension premium system**.
- Intent to **jointly explore** possibilities and consequences of collective risk sharing and more choices in new set-up and map out viable transition path.

Major challeges

- ***Intellectual*** (puzzling): how to combine individual pension pots with collectieve risk sharing?
- ***Distributional*** (powering): how to deal with transtion costs related to abolishing average pension premium system.
- ***Legal*** (puzzling and powering): how to transfer old rights into new ones? How to deal with privileged postion sectorwide pension funds (and ultimately secure the role of unions in the joint management of them?).

Conclusions

- Hard to reform sector wide pension plan. Resilient to change.
- Hybrid DB/DC not a good option (especially in low nominal interest rate environment).
- Hybrid DC with collective risk sharing seems promising alternative. But major challenges ahead.
- Opportunities for mutual learning: the question of how to do better than traditional DC schemes is also discussed in other countries.