Georgetown University
Center for Retirement Initiatives
McCourt School of Public Policy

Blog Post, September 2018, 18-06

The Stress Behind the Dykes: Debating the Next Generation of Retirement Policy Reforms in the Netherlands

By Harry H.G. Smorenberg

As one of the top-ranked retirement systems in the world, the Netherlands' retirement system is often seen as a model due to its strength in "adequacy, integrity and sustainability." However, if you were to ask a Dutch citizen about it today, you would be shocked at how critical and skeptical he or she is about their own nation's retirement system.

Discussing the soundness of pension and retirement savings options in everyday conversation is part of the Dutch way. Fierce debates and finding common solutions characterize Dutch policymaking. This is one of the reasons why the Dutch system is among the top three, according to the 2017 Melbourne-Mercer Global Pension Index. In the Netherlands, a delicate balance has been achieved between employer, employee, and union stakeholders.

Like many other nations, though, the Netherlands is facing a rapidly changing environment that is challenging the long-term viability of its retirement system: an aging society, eroding solidarity among stakeholders, the decreasing influence of unions, and a growing number of self-employed workers. In addition, younger generations today have a very different perspective on work-life balance and want more individual control over their financial planning and future. Technology is also transforming work and society in a way that is leading to a different view of work and income in the future.

As a result of these factors, public opinion about pensions and savings for retirement is changing in the Netherlands. The traditional patterns of work and retirement are being challenged as more people live longer and work longer. We see the focus shifting to a greater interest in personal financial planning with the flexibility to meet shifting needs as people age. These shifts present new challenges for the future of the Dutch retirement system.

The Three Pillars of the Dutch Retirement System

The Dutch retirement savings system is a national system and consists of three pillars.

A national public pension. The first pillar is the public defined benefit (DB) pension component, which is funded by the Algemene Ouderdoms Wet (AOW) Savings Fund. It is a compulsory pay-as-you-go system, providing a guaranteed benefit financed by a payroll tax. This AOW national pension covers employees in the public and private sectors, as well as the self-employed.

Occupational-based pensions and savings. The second pillar is a quasi-mandatory occupational-based savings system and voluntary company pension plans. These plans are financed from employee and employer contributions and the returns on the investment of those contributions. Although there is no statutory obligation for an employer to offer a pension, more than 95 percent of employees are covered by one.

Private savings. The third pillar is voluntary savings with access to private products in the market, such as annuities, endowments, life insurance, or tax-advantaged savings accounts. Since self-employed people are not linked to employers and cannot participate in the occupational pillar, they must supplement their AOW state pensions with individual savings and income products.

As people live longer and move away from traditional work arrangements, policymakers currently face the challenge of workers who increasingly lack trust in the current system and seek greater flexibility, but therefore assume greater risks, in the design of their retirement savings and investment options.

Collective Defined Contribution (CDC) Hybrid as the Current Model for Occupational-based Savings

The Dutch occupational-based savings pillar takes the form of a collective defined contribution (CDC) model, which can best be described as the middle ground or hybrid between a traditional DB model and defined contribution (DC) model. Originally introduced in the Netherlands some 14 years ago, a CDC is a design that includes a defined benefit for employees and a contribution cap for the employer. A CDC is different from a defined benefit in that the CDC is not obligated to meet a certain payout, but rather, has target payouts that can be based on a range of elements, such as the voluntary contributions made or the salary earned. The CDC is also different in that the payout for retirees can change from year to year, depending on investment performance. CDC schemes saw returns of around 7 percent or more over the last decade in the Netherlands — a level of return that is very hard to achieve in individual savings plans.

The contribution levels are an important aspect of the success of the system, but the risk-sharing component at the heart of CDC is the key element. This refers to the sharing of risk with regard to longevity risks, operational risks in the pension delivery, and investment risks. For an individual, it is difficult to understand or be exposed to the volatility of investment risk. The pooling of funds in the Netherlands helps individuals mitigate this risk. By pooling the funds, individuals benefit from large, diversified investment portfolios. These larger portfolios can now also include illiquid investments such as infrastructure. Pooling also allows participating individuals to get access to lower institutional pricing for these portfolios.

Risk-sharing in CDC schemes has always been an integral part of the system. In the Netherlands, the two main types of funds are industry wide funds and corporate funds. After the dotcom bust in the 2000s, rating agencies and corporations became more aware of risks in pension funds and to their balance sheets. The desire to mitigate this risk for corporations while maintaining collective risk-sharing for participants formed the basis for developing the CDC model.

Demands for Reform Could Change Occupational-based Savings

Today, plan participants have less trust in the CDC-based retirement savings system, especially young workers who believe they are paying too much into the system for their rate of benefit accrual. This erosion of trust is a significant change from the historic solidarity of the Dutch public toward its three-pillar retirement savings system. It has led to growing public desire for greater individual control over retirement planning options.

This change in attitude has been happening even though the Dutch retirement system is constantly repositioning itself. In the past decade, there has been a pooling of corporate pension funds as fewer firms manage their funds on their own and consolidate with other funds managed by third parties (leading to a reduction from 1,060 separate funds in 1997 to just 290 in 2016). This allows funds to take more risk within prudent limits and potentially earn higher returns. Consolidation also improves governance and operational efficiency.

Nevertheless, a 2014 government-conducted poll found that 60 percent of the public wanted to choose their own investment portfolios, 58 percent wanted to choose their own levels of retirement savings contributions, and 45 percent wanted to choose their own supplementary pension funds (part of pillar 2). In general, the retirement savings trend from defined benefit toward more-individualized accounts and defined contribution accounts means individuals are increasingly bearing more of the investment risk. More and more individuals want to share in the responsibility for their retirement security and are demanding access to professional advice, as well as more transparency in existing options.

In 2017, the global advisory firm Willis Towers Watson conducted a survey of some 68 employers, collectively employing some 320,000 Dutch residents, on their views of the future of pensions. Of these employers, 70 percent agreed that changes to the pension system are needed. About 80 percent believed the current system was beneficial for older employers, but only 28 percent believed it was beneficial for young employees.

Although most employers expect the new reforms to be generationally fairer, many are concerned that such younger employees will save too little for retirement.

Additional Challenges from Longevity and the Changing Nature of Work

Because people are living longer and the nature of work is changing, policymakers are thinking about how to provide these "non-traditional" workers with savings options while also providing the flexibility necessary to meet the needs of those who work longer.

Living Longer Means Working Longer

Effective January 1, 2018, the target retirement age (TRA) for occupational retirement plans in the Netherlands will increase from 67 to 68. The increase in the TRA was triggered automatically by an increase in average life expectancy, determined by the Central Bureau of Statistics. Depending on individuals' current benefit designs, the new TRA may result in some plans exceeding the maximum level of tax-qualified benefit accrual, unless plan participants take action before 2018 to avoid this outcome. Based on current mortality projections, the next TRA increase is expected after 2025.

The Challenge of Covering the Self-Employed

The labor force in the Netherlands is changing quickly. With more than 1 million self-employed workers and counting, there is a lot of concern about how to cover this population of workers. While there is a general sentiment toward protecting this growing group of employees, some in the present government coalition oppose a mandatory pension for the self-employed. Most parties would prefer to offer a fiscal stimulus or an opt-out system.

The self-employed already have some options, such as saving through the pension plan of a previous employer, and the larger pension funds already offer dedicated options for the self-employed. The issue is the choice between more income in the short term and saving 20 percent or more for retirement security in the long run. The day-to-day reality of self-employed workers reveals a "too little, too late" situation. The self-employed will probably end up with a huge pension gap, or minimal savings in addition to AOW.

Serious Debate Raises Questions about the Prospects for Reform

There are ongoing discussions about the solvency of the pillar 2 occupational-based pension system. Political parties are negotiating a new national agreement to reform the pillar 2 occupational pension structure, and all parties — to varying degrees — have advocated a transition to individual retirement savings accounts and a more generationally fair accrual pattern. The agreement would bring significant change to the Dutch occupational pension system. The changes are expected to be implemented by

2020, but the agreement is subject to negotiations, and all parties and stakeholders must agree before such changes can take effect.

At present, reforms of the current system are the subject of serious debate. Unions might agree with a “deal” as a trade-off for slowing down increases in the retirement age. However, the idea of abolishing or adjusting the guaranteed income component remains very controversial. The plan currently under consideration is the adoption of an approach that would gradually shift from average pension accrual for all workers to decreasing pension accrual for younger workers to smooth a transition to offering younger workers greater flexibility in their investment choices. However, making such a transition comes with costs associated with compensating any workers affected by the shift. These costs are estimated to be between 25 and 100 billion Euros. The cost and complexities of such moves make the decisions difficult, and it will probably take more time for policymakers to make such fundamental changes. A 2020 date for implementing reforms may be too optimistic.

Conclusion

There is a growing awareness in the Netherlands that pensions and individual retirement savings options can and should be much more flexible. It is already possible to postpone the AOW state pension, and there are signs that proposed reforms will include a more flexible option to work part-time and receive pension income while in retirement. This development is needed as life-time employment becomes more common.

There is also a big divide in the labor force. As technology changes how we work, unskilled and low-skilled labor will need opportunities to retrain for new careers at earlier stages of their careers. At present, workers engaged in lifetime physical labor do look forward to early pensions. In anticipation of changing labor needs, however, government reforms should support career shifts and longer working contributions to pensions. Employers also can and should do much more to provide workers with education and training opportunities to either help them continue to work productively within their current industries or to help them transition to new careers in other areas.

On the whole, society should be willing to do more to address retirement savings and lifetime income needs, and policymakers must be willing to address these new challenges. The private sector — in particular, small and medium-sized employers — cannot shoulder the costs and burdens of this growing societal challenge on its own.

Harry Smorenberg is CEO & strategist of Smorenberg Corporate Consultancy, founder of the World Pension Summit, a member of the International Advisory Board CAFF50.NET China (a national think-tank), and an advisor to the Georgetown University Center for Retirement Initiatives.

Additional Resources:

Balter, Anne, Jesper Rangvid, and Malene Kallestrup-Lamb. "Comparison of variable annuities between The Netherlands and Denmark." Netspar. March 2, 2018.

Bovenberg, Lans, and Theo Nijman. "New Dutch pension contracts and lessons for other countries." Netspar. September 2017.

IPE. "Ambachtsheer sets out path to new Dutch pension system." November 14, 2017.

Kennedy, Liam. "CDC: clumsy Dutch construction?" IPE. March 2018.

Pressman, Leen. "Netherlands: Reform delayed." IPE. September 2018 (magazine).

Tapper, Henry. "What is CDC?" April 2, 2018.

Van Dalen, Hendrik P., and Kene Henkens. "Do People Really Want Freedom of Choice?" Netspar. September 20, 2017.