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In this issue of Watson Wyatt Update

- Ministerial regulation as elaboration of the concept of 'consistency'
- Further memorandum of reply on the Amending Act
- Legislative proposal for taxing excessive pay
- Proposals for amendments to the reporting guidelines

Ministerial regulation as elaboration of the concept of 'consistency'

By means of a ministerial regulation, Minister Donner has elaborated on the concept of 'consistency'. Consistency is of key importance in the assessment of the benefits policy of pension funds since it is connected to other aspects of the financial set-up. The concept of consistency is also used to assess the lawfulness of contribution discounts. This, in combination with the existing uncertainties, makes the regulation an extremely important one.

According to Section 95 of the Pensions Act (*Pensioenwet*), funds must – in the event of the conditional conferral of benefits – provide for a consistent whole with respect to expectations, the financing and realisation of conditional benefits.

Consistency is achieved, as the minister now states, when the expected supplementary allowances in a continuity analysis based on the regulatory own funds match the supplementary allowances target. With this a distinction is made between the expected conferral of supplementary allowances like this from the continuity analysis and the expectations, which are considered as equivalent to the supplementary allowances target.

If this requirement is not satisfied, the fund can then choose as a starting position a coverage ratio above the regulatory own funds in order to fulfil the supplementary allowances target in the analysis.

Furthermore, it must be demonstrated that a pension fund has enough recovery strength to ensure solvency position growth in fifteen years from the minimum regulatory own funds to the regulatory own funds, or at least to the higher starting position applied.

DNB can grant permission to implement this exercise from an initial coverage ratio that is higher than the minimum regulatory own funds, or to not implement it at all.

The consequence of this new regulation is that, so far, non-obligatory alternatives to the continuity analysis are necessary in order to check whether a pension fund's policy satisfies the legal requirements. Watson Wyatt will, of course, adjust future reports accordingly. If so desired,

previously conducted analyses can also be expanded in order to meet the provisions in this regulation.

Watson Wyatt's standpoint is that the regulation, as it is now proposed, satisfies an existing need: namely a clarification of the concept of 'consistency'. Time will tell to what extent it has resolved the problems. The regulation states, for example, that the requirements have been met when there is a 'sufficient degree' of correspondence between the expectation and the target. In practice it remains to be seen when this 'sufficient degree' can be regarded as having been reached.

Further memorandum of reply on the Amending Act

In a further memorandum of reply, Minister Donner answered questions from the Upper House regarding the Amending Act. On 8 July the proposal was dealt with as a formality.

WGA

Following the draft decision already released regarding the implementation of the Pensions Act and the Occupational Pension Scheme Act (*Wet verplichte beroepspensioenregeling*) in connection with the implementation of occupational disability regulations, the question was posed as to why the Minister of Social Affairs and Employment allows pension funds to cover the unemployment risk. The government believes that, if a supplement to a WGA subsequent benefit and a WGA salary supplement are implemented according to the proposed further rules, there is no coverage with respect to the unemployment risk. From the draft decision it is apparent that the total income of someone who is partially unfit for work always increases by at least the earned income by means of the remaining earning capacity. If less than the remaining earning capacity is used, the individual unfit for work also bears the risk for loss of income. For this reason, the provisions in the draft decision are, in the opinion of the government, not to be regarded as an unemployment supplement.

As a transitional law, the draft decision provides that insofar as a supplement to a WGA subsequent benefit and a WGA salary supplement is not an invalidity pension as defined in the Pensions Act, these supplements are to be considered invalidity pension as defined in the Pensions Act until 1 January 2009. This provision has been included in order to clarify that pension funds may continue to implement the supplementary occupational disability regulations already being implemented until 1 January 2009. This transitional provision does not apply to insurers. Insurers have this time to prepare themselves for the fact that part of the supplementary occupational disability regulations will fall under the Pensions Act as of 1 January 2009. The government is of the opinion that this is a feasible period of time for insurers.

The government intends to take account of mandatory collective agreements which involve supplements to WGA subsequent benefits and WGA salary supplements. The substantive provision of the draft decision will only apply after the period of the mandatory collective agreement.

Direct elections of board members by pensioners

The question was posed as to whether there is a need for direct elections of board members by pension recipients, if the board member is elected by the section of pension recipients in the participation council who, in turn, were already elected by pension recipients. General elections would then no longer be obligatory. The government finds, based in part on the participation agreements of 1998 and 2003, that no amendments need to be made at this time with respect to decision-making participation in pension funds. Accordingly, representatives of pension recipients on the board of a company pension fund must be elected by and from the pension recipients.

Legislative proposal for taxing excessive pay

With a view to implementing the Kortenhorst motion, State Secretary De Jager and Minister Bos of Finance submitted the legislative proposal 'Taxing excessive pay components' to the Lower House on 13 May 2008. This legislative proposal, which is part of a broader package of measures proposed in relation to pay policy, includes three tax measures. Together, these three measures are intended to replace the original proposal of setting an upper limit on the deferred taxation system of €185,000. Details concerning the three measures can be found on the website www.watsonwyatt.nl/update.

Proposals for amendments to the reporting guidelines

In recent months, amendments have been proposed for three reporting guidelines regarding pension obligations. These are the European (IAS 19), Dutch (RJ 271) and English (FRS 17) guidelines. When they ultimately take effect, a number of the proposed amendments will have quite far-reaching consequences. However, it is by no means certain that they will take effect, and that will not be the case for at least the next few financial years. One exception relates to the less drastic amendments to the Dutch reporting guidelines which could already take effect in the short term.

IAS 19

The proposed amendments constitute the first phase of a two-phase plan. An important part of this is having the distinction between Defined Benefit (DB) and Defined Contribution (DC) change into an distinction between Defined Benefit Promise (DBP, which pertains solely to final salary schemes) and Contribution Based Promise (CBP, which pertains to all other regulations, including average salary schemes). For the time being, the current calculation method (Project Unit Credit method) will remain in effect for DBP, while a Fair Value method will apply to CBP. The details of the latter method are not yet known.

In addition, the notional interest rate used will no longer be based on the return on high value corporate bonds, but on the creditworthiness of the company or the administrator of the regulation.

Lastly, it has been proposed to change the processing of profits and losses. Three alternatives have been put forward for this. In the most radical proposal, all profits and losses are channelled directly through the profit and loss account. The other two are more complicated, but they too involve more fluctuations in the profit and loss account.

RJ 271

In the proposed amendments to RJ 271, it appears as if a head start has been taken on discussions yet to be held at a 'higher' level and in the much longer term. For example, future salary increases are not going to be taken into consideration in the case of average salary schemes.

In addition, the distinction between DB and DC is to be expressed in clearer terms. Attention will also be paid to CDC (Collective DC) regulations. There will be a specification as to which conditions these regulations have to satisfy in order to be regarded as DC regulations.

Furthermore, the conditions will be laid down for smaller employers concerning when they may implement their pension obligations based on roll forward.

FRS 17

This proposal is less concrete than the other two proposed amendments, but it reconsiders a number of fundamental assumptions. For example: should the individual – or even the general – salary projection be taken out of the valuation? Should the credit spread be taken out of the discount rate? Should the attenuation be taken out of profits and losses?

As already mentioned, the amendments are all far from definitive. The results of the current consultation rounds will partly determine whether and in what period they will be finalised. Watson Wyatt will keep a close eye on all discussions and will publish the results in this newsletter when there is reason to do so.

Further information

If you would like further information about the matters addressed in this issue of the Watson Wyatt Update, please contact Wichert Hoekert (Ministerial regulation as elaboration on the concept of 'consistency' and Proposals for amendments to the reporting guidelines), Marijke Bieling (Further memorandum of reply on the Amending Act) or Jetty Lahoye (Legislative proposal for taxing excessive pay).