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Phase II of the API

Many company pension funds (CPF) are currently looking for partnerships, owing in part to the increasing regulatory burden. Partnerships may take shape in various ways, for example through asset pooling and organising know-how and expertise. However, these options do not offer solutions for cohesive management, member participation or pension fund governance. It should be possible for CPFs to work for multiple companies. That is why the Dutch Ministry of Social Affairs and Employment has introduced a “multi-CPF” for phase II of the API.

The current definition of responsibilities under the law means that it is impossible for CPFs to merge. Under the system of separation of fields of operation, CPFs may only work for one or more schemes belonging to one company or group of companies. Partnerships will only be possible if the system of territorial limitation is modified. However, the next problem that the CPFs encounter is the requirement for a single financial whole. Owing to that requirement, funds administering multiple schemes are not allowed to reduce the claims under one scheme as long as the fund's total equity is still sufficient; this is known as cross-subsidising. To make optimum use of the multi-CPF option, the requirement for of a single financial whole will have to be abolished in order to allow ringfencing of the assets of the various schemes. The FTK will then apply to each financially distinct part. Multi-CPF will retain the option of choosing a single financial whole, i.e. the option of choosing mutual solidarity.

The multi-CPF as currently proposed is a CPF that works for multiple companies, without any connection existing between those companies. This does not prejudice the essence of the pension fund. The social partners involved in the creation of a pension scheme remain responsible for that scheme's administration. The board of a multi-CPF must have equal representation. That equal-representation board has control over the schemes of all contributing companies. This serves as a natural limitation on the number of contributing companies for which the multi-CPF can or will wish to work. Another important factor is that the governance requirements remain in place for multi-CPF. This means that they must have accountability bodies and internal supervision. The relevant provisions in the Dutch Pensions Act will be

amended to make this approach feasible. However, requirements will be specified for the composition of the participants' council. One proposal is to stipulate that, if a multi-CPF administers schemes for multiple companies, each company must have at least one representative on the participants' council from each of its segments.

This approach may appeal to multinationals with various branches in multiple Member States, as the multinational can also administer financially separate schemes within the context of a multi-CPF. However, foreign parties may not be as familiar with the figure of a Dutch CPF and the related requirements as regards governance. A solution might be found in Section 212 of the Pensions Act, which allows the Dutch Central Bank (DNB) to grant a dispensation from the regulations on boards with equal representation, pensioners' participation and the formation of the participants' council. For these purposes, the governance structure commonly used in the Member State or States may be taken into account.

Owing in part to the sensitive issue of the definition of responsibilities, the background memo has been referred to the STAR for advice. The STAR's advice is expected to be ready towards the end of January.

Consistency test and use of the supplementation matrix

The amendment to the Regulations on the Pensions Act and the Act on Obligatory Occupational Pension Schemes (*Regeling Pensioenwet en Wet verplichte beroepspensioenregeling*) introduced the consistency test and a new version of the supplementation matrix (see also Update no. 7, volume 11). The consistency test is particularly important for pension schemes with conditional supplementation based on an ex-ante standard (such as the price index). This test can be used to determine whether the expected supplementation from the in-balance situation matches the supplementation ambition ‘sufficiently’. Previously, no uniform method existed for determining the consistency between financial policies and the conditional supplementation based on an ex-ante standard: pension funds were at liberty to demonstrate consistency in whatever way they chose. A very important factor in these tests is how the Dutch Central Bank defines the standard of ‘sufficiently’. For the portion of the test that concerns the required own funds, the Dutch Central Bank has stated at public meetings that it would take a minimum percentage of 70% as the point of reference, which is a standard that we consider to be lenient. Since it has not been common practice to date to lay down ambitions in regulations, it is understandable that a lenient standard is to be applied. Nevertheless, it would seem advisable to us that pension funds and/or social partners determine for themselves whether 70% represents a consistent whole. Naturally, using a higher percentage has financial implications that may be less

than desirable in the current climate.

The introduction of the consistency test means that pension administrators and social partners will be forced to test whether their own previous perceptions of the concept of 'consistency' match the definition adopted by the authorities. In extreme cases, this may necessitate modifications to ambition levels and/or financial policies. An interesting factor here is the impact of the option in the regulations of granting catch-up indexation. Whether or not catch-up indexation can be granted proves to have a potentially significant impact within the consistency test.

In addition to the consistency test, a modified supplementation matrix has also been published, with amended texts. The prescribed texts are to be incorporated in cases of conditional indexation. The statutory texts for pension regulations and individual information for the various forms of indexation have not been worded with very close attention to detail. For example, most participants will read the words 'shall' and 'will' and have the impression that the supplementation is practically unconditional, whereas in fact the purpose of using these texts is to emphasise the conditional nature in clear and understandable terms. We understand from our dealings with the Netherlands Authority for the Financial Markets (AFM), the Dutch Central Bank (DNB) and the Ministry of Social Affairs and Employment (SZW) that addendums to the statutory texts are permitted, provided that they serve to enhance clarity. The added text need not be submitted to the AFM as long as it does not infringe upon the statutory texts, we are told by the AFM. Therefore, it can do no harm to emphasise the conditional nature even more than is currently the case.

Value transfers and insufficient coverage

Pursuant to the Pensions Act, pension administrators are obliged to cooperate with any statutory individual transfers of accrued pension rights. However, if the pension administrator's financial situation is poor ("in which the technical provisions are no longer fully covered by assets"), the Pensions Act temporarily suspends that obligation. One reason for this suspension is to prevent further deterioration of the financial position as a result of outgoing transfers, while another is to protect new participants in cases of incoming transfers. A financial position is considered to be poor if the coverage ratio is less than 100% (pension fund), or in the case of an emergency facility or bankruptcy (insurer).

Pension administrators are obliged to apply this suspension of the obligation to cooperate with statutory transfers of accrued rights if the membership commenced on or after 1 January 2007, since the Pensions Act became effective on that date. Temporary suspension is also possible in the case of membership with the pension administrator that commenced before 1 January 2007, pursuant to the Act on the Introduction and Amendment of Global Compensation and Benefit Governance in the Pensions Act (*Invoerings- en aanpassingswet Global Compensation and Benefit Governance Pensioenwet*). In that situation, the Dutch Central Bank must judge that, in its opinion, the pension administrator's financial situation does not permit it to cooperate with mandatory transfers of accrued rights.

Once the financial position has recovered, the statutory right to transfers of rights applies once more, and the workers or former workers must be notified as quickly as possible.

Defined contribution schemes and turbulent financial markets

In a letter sent to insurers on 14 November 2008, the AFM drew their attention to the impact of the current financial market situation on defined contribution schemes, in connection with the performance of their duty of care as laid down in Section 52 of the Pensions Act. Pursuant to that clause, insurers must implement their duty of care by 1 January 2009 at the latest, by offering full freedom of investment, applying the life-cycle principle, or leaving both of these options open.

In practice, the life-cycle principle is often applied, which involves spreading risks and gradually decreasing the price risks on shares, in particular. In view of the current situation on the financial markets, it may be disadvantageous to strictly apply the principle that the investment risk is to be decreased as the retirement date approaches, as this would mean that the participants have to incur some degree of loss.

The AFM is therefore urging insurers to consider alternatives, for example postponing the conversion. Another option is not to convert the investments accrued to date. The AFM stresses that in choosing how to fulfil the duty of care the insurer makes a substantiated assessment, which will be in the participants' interests in view of the current market situation and product composition.

In our view, the problem is even worse in situations where the worker will reach his or her retirement date under the regulations in the immediate future. Despite the fact that the ultimate responsibility for the investments lies with the participant, the recent drop in share prices and the low level of interest rates will result in substantially lower pension benefits. This is an argument for reintroducing the option of making what is known as a pension cut. Unlike the tax facilities, the Pensions Act does not allow for the possibility of deferring the purchase of some or all of the pension benefit. This stems from the fact that the participant must not bear any risk on his or her retirement date. The participant must use the full capital. Making such a cut will mean that the full pension capital need no longer be converted at the prevailing share prices and interest rates. Partial deferral of the purchase of pension benefits may mean that in five years, for example, higher benefits can be purchased (once the investments have recovered and the interest rates are higher). Pension funds are also facing these problems.

Global Compensation and Benefit Governance

In recent years, compensation and benefits governance has been high on the agenda of many companies. This has been driven in part by concerns around the impact of benefit costs on companies' finances, a general move toward effectively managing financial and legal risks in the wake of corporate scandals and a trend to harmonise the treatment of benefits in the areas of accounting standards and financial reporting.

The recent market turmoil and the potential economic downturn confront companies with further significant challenges requiring quick and strong decisions. Given the global nature of the current economic malaise, companies need a global response in the compensation and benefits environment which is based on a strong and robust global decision making process.

Global Compensation and Benefit Governance is a system of decision-making structures, processes, practices and values that enable an organisation to make good and actionable decisions. This enables it to mitigate risk associated with compensation and benefits around the globe. The main elements of the governance process include assessing the current state in the organisation, developing strategies and structures and clearly communicating roles and responsibilities from the Board, through Corporate to the local business level.

Besides the abovementioned advantages of good global governance it also creates an environment in which the strategic advantages that compensation and benefit structures can provide are more likely to be realised. Furthermore, governance allows for efficient management of information throughout the organisation including greater transparency, the leveraging of global purchasing power, research, experience and intelligence and the building of a global company brand.

The attached [article](#) provides more insight on Global Compensation and Benefit Governance. Watson Wyatt will organise a OneWorld seminar on the subject of Global Governance on 24 March 2009. We will provide more information about this seminar in due course.

Further information

If you would like further information about the matters addressed in this issue of the Watson Wyatt Update, please contact Rick Crauwels (Phase II of the API), Jeroen Röder (Consistency test and use of the supplementation matrix), Sandra Bertram (Transfers of accrued value and insufficient coverage), Eric Heemskerck (Defined contribution schemes and turbulent financial markets) or Danny Vercruyce (Global compensation and benefit governance).