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Are multi-company funds the saviour of small pension funds?

We recently reported on the bill to introduce multi-company pension funds, which is currently before the Lower House of the Dutch Parliament. The main aim of the bill is to tackle the problems that are endangering the future of smaller pension funds. However, the question is whether this bill offers sufficient remedies to tackle those problems.

Merging of pension funds

The bill is intended to allow different pension funds to increase efficiency levels by merging with each other. There are two ways in which pension funds can be merged:

1. By liquidating the merging pension funds and establishing a new joint pension fund
2. By liquidating one pension fund which then joins an existing pension fund

However, there is one major handicap, because these methods are only possible with pension funds that have been in existence for at least five years. Therefore, funds that have existed for less than five years and directly insured schemes cannot be absorbed into a multi-company pension fund. It is also not possible to combine pension funds by means of a merger, which could definitely be a very practical solution in the case of a multi-company pension fund because merging two legal entities is often more efficient than liquidating one in order to transfer its rights and obligations to another legal entity.

Ringfencing

The Pensions Act (*Pensioenwet*) states that a pension fund that administers more than one scheme must form a single financial unit. The bill currently before Parliament provides for an exception to that rule: assets must be kept separately per company or group that is a member of the fund. It is unfortunate that this ringfencing of assets is now mandatory in this proposal and not optional – as in the original draft of the bill – because it is certainly possible to conceive of situations where ringfencing by no means has to be the obvious solution. The bill also fails to make clear how the separation of assets works out in the event of bankruptcy.

Membership of the fund's administrative bodies

The bill also states that there must be at least one employer's representative and one employees' representative per member company or group on the pension fund board. The Explanatory Memorandum clarifies this provision to the effect that it is not permissible for a single representative to join the board and act on behalf of more than one company. The Memorandum refers in this regard to a 'natural brake' on the number of merging funds. This will apply even more so if pensioners claim a position on the board. Furthermore, this requirement may be an obstacle in practice if funds of different sizes wish to merge. It is unfortunate that the task of deciding how to distribute the seats on the board and how to fill them has not been left to the 'social partners' (i.e. the employers and the unions). The multi-company pension fund could well be the ideal organisation to have a professional board that only handles the tasks relating to implementation.

The bill also includes extra requirements as regards the members' council: at least one employees' representative and one pensioners' representative must sit on the members' council per member company or group. This requirement regarding the pensioners' representative on the members' council applies whether or not there is already a pensioners' seat (per company or group) on the board.

The bill does not include any provisions regarding the accountability body. Therefore the bill leaves this issue open, but major problems are nevertheless expected because accountability applies per scheme, which results in an unmanageably large accountability body.

Positive sides

There are also positive sides to the bill that is currently before Parliament. For example, the numbers required as regards directors, members of the members' council and members of the accountability body will normally be smaller than in the case of a company or group with its own pension fund. It will therefore be possible to limit any problems with succession and to put the emphasis on quality. Another advantage is that a single pension administration apparatus is sufficient, which cuts down on costs (even more so if the apparatus includes a joint asset management system). However, the same result can also be achieved *without* a multi-company pension fund, by means of a joint pensions office, a buyers' cooperative and the pooling of asset management. The option of a mutual benefit company as a vehicle is also worth considering because it is not affected by the limitations of a multi-company pension fund. In short, a multi-company pension fund is a step in the right direction, but Watson Wyatt believes that a number of amendments still need to be made to the bill before it genuinely represents a good solution. Watson Wyatt is currently developing a multi-company pension fund based on the bill. We will keep you informed.

Government plans to raise the state (AOW) and supplementary pension age to 67

It will not have escaped your notice that the government has put forward plans to reform the state pension system (AOW). These plans will be the subject of much debate in the coming period. The following brief summary of the various measures is followed by a more detailed explanation.

Measures

- The state pension (AOW) age will be raised to 66 with effect from 2020 and then to 67 with effect from 2025.
- People who have worked at least 42 years (for at least 3 days a week) will be able to retire at 65, but they will receive a lower state pension (8% less on an annual basis).
- People who have worked for at least 30 years in a mentally or physically difficult job must be given lighter work by their employer, or the employer will have to make a financial contribution that is sufficient to ensure that the person can retire at 65.
- A new income-related employed person's tax credit will be introduced for older workers to encourage them to continue working for longer.
- Anyone who loses his or her job or becomes unfit for work before the age of 65 – and whose wage-related benefit under the Unemployment Insurance Act (WW) or under the Return to Work (Partially Disabled) Regulations (WGA) comes to an end – will be entitled to benefit in the amount of the state pension (AOW) until he or she is 67.

Explanation

The letter dated 16 October 2009 sent by Minister Donner and State Secretary Klijnsma to the Lower House of the Dutch Parliament states that the precise definition of 'mentally or physically difficult jobs' will have to be clarified during the introduction period. The specific jobs concerned will have to be identified over the next ten years – partly based on input from employers and unions ('the social partners'). During this ten-year period employers and employees will also have to introduce a sustainable employability policy for temporary alternative work.

It will also be difficult initially to determine everyone's employment history. A register will therefore be compiled during a transitional period. From 2020 onwards, people who have worked in the previous 15 years will then be able to retire on state pension (AOW) earlier. One year will be added to this fifteen-year requirement every year after 2020.

As well as the state pension, the supplementary pension age will also be increased to 67 with tax law being amended accordingly. The two amendments required will be as follows:

1. The maximum accrual percentage will be based on retirement at 67 instead of 65;
2. The accrual percentage permitted under tax law will be reduced. It is therefore logical that the current fiscal maximum accrual percentages will be multiplied by approximately 35/37, because the intention was that it would be possible to accrue a full 70% pension in 35 years. This period will now be extended by two years

to 37 years.

The government intends to introduce these fiscal changes in one package with effect from 1 January 2020 but it has invited the social partners to enter into agreements in this regard. It therefore seems that the fiscal changes will not take place in two stages (as with the state pension (AOW)), but instead in a single package and not until 1 January 2020. Employers and the unions can apparently still influence precisely what will happen.

What comes next?

For the time being, the proposals have the status of a government plan. In due course, they will become legislative proposals and will be submitted initially to the Council of State for recommendations. Once the Council has made its recommendations, the legislative proposals will be sent to the Lower House of Parliament, at which time they will be made public. It will still be possible to amend the proposals whilst they are before Parliament. The government's plans raise a lot of questions. We intend to use the information available to us in the coming period to gain insight into all of the consequences that these plans may have for pension schemes. For this purpose we have set up a multidisciplinary team bringing together all of our experience and knowhow. We would like to share the insight that we acquire with you and we will soon be organising a seminar and/or one or more lunch meetings for that purpose. We will inform you as soon as dates and locations have been decided.

Association of Actuaries report on yield curve

On 12 October, the Association of Actuaries (*Actuariële Genootschap*) in Utrecht published a report about the yield curve to use when valuing the liabilities of pension funds and insurance companies. Since the introduction of the Financial Assessment Framework (FTK), the Dutch central bank (DNB) has prescribed the so-called 'FTK yield curve' – which is based on the swap curve – for evaluating the liabilities of pension funds. The FTK yield curve consists of interest rates at which a variable six-month EURIBOR can be exchanged for a fixed interest rate. Partly because of the assumed distortion at the end of 2008, a debate has arisen over the past year regarding whether this curve is indeed the correct curve to use.

In its report entitled "Yield Curve Principles – There is no such thing as the correct curve" ("*Principes voor de rentetermijnstructuur - De juiste curve bestaat niet*") the Association of Actuaries states a number of principles that should be adhered to by a yield curve that has the aforementioned aim. Watson Wyatt subscribes to these principles and also draws the same conclusion as the report, namely that the swap curve is currently the best basis for valuing pension fund liabilities.

More information

For more information on the matters covered in this issue of the Watson Wyatt Update, please contact Rick Crauwels ('Are multi-company funds the saviour of small pension funds?'), Jeroen Röder ('Government plans to raise the state (AOW) and supplementary pension age to 67') or Wichert Hoekert ('Association of Actuaries report on yield curve').