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Supervision of investment policy may be tightened

On 17 September 2009, the Dutch Central Bank (DNB) issued a press release stating that an in-house study had revealed that a number of pension funds underestimate the risks of their investment policy. This study will serve as the point of departure for the Investments and Risk Management Committee, chaired by Mr Frijns and established by Minister Donner. This committee will analyse the developments in the composition of the investment portfolio for the entire pension sector and make recommendations for the future.

In addition, DNB director Joanne Kellerman indicated during a recent meeting that the risks will be assessed in a wider perspective, which also includes active investment policy, complex derivatives transactions and the outsourcing of activities. The above statements by DNB are in line with Section 135 of the Pensions Act (*Pensioenwet*), which contains requirements in respect of investments. These requirements state that pension funds must conduct an investment policy that is consistent with the prudent-person rule. The annual assessment falls within the responsibilities of the certifying actuary. In the past year, the actuarial certificates for a number of pension funds already recommended that specific elements of the investment policy be improved and/or reconsidered.

We agree that risk management should play a central role in the investment policy of pension funds. The most conspicuous consequences of insufficient risk management occurred following the collapse of Lehman Brothers, which caused a substantial number of Dutch pension funds to suffer losses of varying amounts. A large part of these losses could have been prevented if more attention had been paid to the implementation of the policy conducted and the monitoring of the various risks it entailed.

It is extremely important that pension fund boards are aware of the risks attached to their investments. In our opinion, therefore, a critical assessment of the investment policy is indispensable – especially as regards the requirements imposed as part of the prudent-person regulations.

Insufficient compliance with duty of care regulations

Defined-contribution schemes with discretionary investment powers entail a duty of care for the pension administrators. In fact, this means that pension administrators must carefully

monitor the choices made by the participants. Especially at the present time, when it has once again been shown that the investment profile can have a major impact on the eventual pension, it is important that a participant does not take any rash decisions.

However, the results of a self-assessment conducted by the Netherlands Authority for the Financial Markets (AFM) among pension insurers have shown that the duty of care is not yet implemented sufficiently. In particular, the compilation of the client profile and the provision of advice to the participant are still below par. The AFM awarded individual scores to the pension insurers to which the duty of care applies based on the results of the self-assessment. The objective was to attain a 100% score. The average score was only 64%, however. Therefore the AFM will shortly contact the low-scoring pension insurers so that further investigations can take place. Where necessary, this may be followed by formal measures.

Although the primary responsibility for proper implementation of the duty of care lies with the pension administrator, the employer also has an important task in this regard because employers do not want to create false expectations in relation to a major condition of employment such as pension. We therefore recommend that companies draw up an annual plan and use this plan to periodically review the various aspects of the scheme, including the implementation of the duty of care.

UPO not always issued in time

The results of a self-assessment conducted by the AFM among pension insurers have shown that the provision of the Uniform Pension Overviews (UPOs) can be improved. A UPO had to be provided 'in time' in 2008. In practice, the fourth quarter of 2008 was still regarded as in time. The self-assessment revealed that a small majority of the pension insurers had failed to issue any, or some, 2008 UPOs even within this period. Six insurers had even failed to issue more than half of the 2008 UPOs in time.

This is an undesirable situation, which has rightly been flagged up by the AFM. The AFM recently determined in a policy rule that, from 2009, the UPO must be issued in the third quarter at the latest. The AFM will assess all pension administrators on this point. If the UPOs were not issued in time, measures may be imposed. Based on these findings, the Government will decide in mid-2010 whether adjustments are required.

Focus on knowledge transfer

In recent years, the requirements imposed as regards the expertise of a pension fund board have become increasingly strict. Watson Wyatt agrees that the principle of developing expertise is beneficial to the pension sector. In setting up the Watson Wyatt Academy as a coordinating body for all matters relating to knowledge transfer, we want to make a contribution to the further professionalisation of the pension sector. Because of our many years of experience and the broad expertise of our consultants, we have a complete picture of the entire pension market. We know what concerns are on the agendas of the pension fund boards. Our tailor-made training programmes enable us to provide the perfect solutions. More information

about the Watson Wyatt Academy can be found on the website at www.watsonwyattacademy.nl.

Review committees

The principles for proper pension fund management have been enshrined in the Pensions Act since 1 January 2007. Based on these principles and on the Pensions Act as a whole, the performance of the pension fund board must be subject to adequate and transparent internal supervision by independent experts. If the fund decided to establish a review committee, the first review must be carried out by 1 January 2010. In practice, it turns out that many funds are finding it difficult to set up a review committee. Several parties have told us that there is a need for a pool of pension fund managers, enabling the boards to arrange the reviews among themselves. The establishment of the pool, known as the RC pool, will be facilitated by Watson Wyatt.

The procedure is as follows: every interested pension fund provides at least two representatives as members of the RC pool. Subsequently, a review committee is put together from the RC pool for each fund taking part. Obviously, due care will be taken to ensure that the members of fund A and fund B do not carry out each other's reviews. In this way, the committee's independence will be guaranteed. Of course, talks will be held to jointly determine the composition of the review committee. One important condition is that the participants in the RC pool know how a review must be carried out. No Watson Wyatt employees will take part in the RC pool. Watson Wyatt will facilitate the RC pool, help the funds put together a review committee from the RC pool and provide proper training for the (prospective) members of the review committee. For this reason, a course will be organised in the autumn of 2009 which is open to all interested parties.

Discount rate in shallow bond market

The IASB has issued a proposal to change the notional interest rate under IAS19, on which a decision will be taken in the near future. This only involves countries which do not have a deep market for high-quality corporate bonds. The rule that applied – and still applies – to these markets under paragraph 78 of IAS19 is that the rate must be based on the rate in respect of government bonds. Now that the credit spreads on high-quality corporate bonds have risen to such high levels, this means that otherwise identical pension commitments result in a much higher liability in those countries. To resolve the situation, the proposal is that these countries, too, should use a notional interest rate based on corporate bonds in the same currency.

Therefore nothing will change for the discount rate applied in the Netherlands; the possible change will only be relevant for companies with offices in those countries where this problem occurs.

These are countries such as Sweden, Norway, India and South Africa. The intention is to implement the change in the immediate future, so that the amended method can already be used at the end of this year.

However, the IASB has pointed out that this change does not mean that it takes the view that high-quality corporate bonds are the correct point of departure for the valuation of pension commitments. The only objective of the change is greater consistency among different countries.

Parameters unchanged in 2010

On 25 September, Minister Donner announced that the parameters in 2010 will remain unchanged compared to the current parameters, as laid down in the Parameters Regulations (*Regeling Parameters*). These parameters can be used in

determining the cost-effective premium and in the continuity analysis. The parameters are the minimum and maximum expected yield rates that may be applied in these calculations.

The reason why no changes were made is that the Don Committee, which was to advise the Minister in the context of the statutory three-yearly reassessment, was unable to reach a unanimous opinion. Representatives of DNB and the Netherlands Bureau for Economic Policy Analysis (CPB) advocated a 1.5% reduction of the maximum yields on securities, whereas representatives of the social partners envisaged a reduction of 0.25% to 0.35%. The Minister has now opted to extend the parameters currently in force by another year. In this way, he has met the wish of the Labour Foundation – expressed earlier – to make the reassessment of the parameters concurrent with or dependent on the evaluation of the Financial Assessment Framework (FTK) and the pension system as a whole, which is scheduled for the middle of 2010.

Bill on Multi-CPFs submitted

On 23 September, Minister Donner submitted a Bill to the Lower House which will enable cooperation between corporate pension funds.

Corporate pension funds will be allowed to amalgamate in the future. To this end, Minister Donner has submitted an amendment to the Pensions Act. By means of this Bill, the Minister wants to help small corporate pension funds in particular. These pension funds find it increasingly problematic to satisfy the requirements of the Pensions Act. They have difficulty finding people with the required knowledge for positions on the board, the participants' council and the accountability body. They are therefore eager to amalgamate with other corporate pension funds.

The Bill does contain a number of restrictions, however. The pension funds involved must be existing pension funds that were associated with a company or a group of companies for a minimum period of five years before the amalgamation. Furthermore, at least one employer representative and one employee representative must be appointed to the board of each company or group of companies. In addition, the Bill provides that each company or group of companies must be represented on the participants' council by a participant and a pension recipient. These are new requirements compared to the preliminary draft published earlier.

Another new element is that ring fencing will become compulsory. The amalgamating funds do not share the financial risks, because each fund retains its own equity capital. This means that the FTK must be applied to the financial whole for each separate scheme. Both the premium structure and any recovery measures will be determined in this manner. The board of the Multi-CPF will be responsible for everything and will therefore have to decide as a full board on the individual schemes. However, decisions may be prepared by a smaller management team. The Bill mentions supplementation as an example.

What is unusual about the Bill is also that the Council of State criticised the documents submitted quite sharply on a number of points. Some of the criticism resulted in the Bill being amended. The Council's comment that the Bill seems to be less suitable for the amalgamation of a larger number of corporate pension funds still applies, however.

More information

For more information on the matters covered in this issue of the Watson Wyatt Update, please contact Sander Gerritsen ('Supervision of investment policy may be tightened'), Jeroen Röder ('Insufficient compliance with duty of care regulations' and 'UPO not always issued

in time'), Angelique Plekker ('Review committees'), Wichert Hoekert ('Discount rate in shallow bond market' and 'Parameters unchanged in 2010') or Rick Crauwels ('Bill on Multi-CPFs submitted').