Pension 2025

Scenarios for the future of the pension sector

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1. Introduction

In 2016 the Cabinet of the Netherlands set out on a course to revise the pension system. Whether the new Cabinet will follow the same course or head for a different direction cannot be foreseen as of the writing of this report. The discussions regarding pensions are ongoing and political positions are divided.

The future of the pension system depends on more than just the legal framework. The extent of flexibility within the legal framework will be highly dependent on economic conditions, changes in supply and demand, as well as the choices of the social partners[1] and participants in pension plans.

Organisations are confronted with more opportunities and challenges when the economy flourishes and interest rates are high than when compared to a stagnating economy with low interest rates. It remains to be seen whether the trend of increasing use of individual pension plans continues, or if collective arrangements will remain dominant. In any scenario there will be room for strategic choices, a differentiated market approach and innovations. An organisation will need to consider what opportunities may arise and what choices it will need to make to be ready to react to new situations.

Government, social partners, pension funds, pension administration organisations, insurers and scholars have already been discussing the future of the pension system for years now. Revisions have been deemed necessary, due to changes in the labour market, longevity, an ageing population, lower interest rates, reduced and more volatile returns, guarantees that are more difficult to honour and a diminished trust of participants in pension schemes. All sides involved do not yet fully agree upon what needs to be done. Experts tend to choose an approach matching their own area of expertise, vision or goal. What one sees as an absolutely necessary adjustment, is regarded by others as unnecessary or even impossible. Reputable institutions produce forecasts for various alternatives which experts disapprovingly respond to with comments about incorrect assumptions used. Politicians and social partners need to find a common direction from a stream of divergent opinions and interpretation of data.

The revision of the pension system, and additional developments that the pension sector will go through, will have significant consequences for the different parties involved. First off, we will consider the individual participant in pension schemes. Most importantly, individuals do not only wish to receive a good pension, often they also want a fair distribution of premiums and pension payments between young and old, high and lower incomes etc. Additionally we have the employers, pension funds, pension administrators and insurers. Depending on the future scenario that may unfold, new entities such as banks, foreign pension providers and technology companies may also be stakeholders. All these players are at least partly responsible for the direction, phasing and duration of the upcoming pension system revision.
Not only by means of their contributions to discussions, but also through the influence of their behaviour on other stakeholders, especially the participants in schemes.

Of the current players, some will disappear, because they are insufficiently capable or willing to adapt to changes in the pension sector. Smaller pension funds, especially, seem to await this fate. Although, some larger entities may vanish too. Pension administrators will either gain or lose ground and may disappear after a transition period. In the past, however, we have seen that the fortunes of entities can take a turn, and that lagging behind can unexpectedly become an advantage. Even for experts it can be complicated to oversee the sector, gauge forces at play and make an assessment of opportunities in time. Strategic choices are sometimes driven by the fear of missing out.

1 Social partners refers to representatives from organisations of employers and employees.

“Strategic choices are sometimes driven by the fear of missing out”

Pensions are an important topic in society in which PwC has a significant involvement. For decades we have advised social partners, corporations, pension funds, pension administrators and insurers to help them to find their way in an evolving pension sector. PwC has conducted strategic research on pension topics. For example, it has recently managed the establishment of new entities, such as “Premiepensioeninstelling” (PPI) and “Algemeen Pensioenfonds” (APF).[2] This expertise has, by means of frequent contact with policy makers and scholars, led to a broad insight in the functioning of the current complex pension system, its ramifications to other areas, and opinions regarding the future of the pension sector. Using this experience as a basis, PwC has analysed the factors and forces that are expected to determine developments in the pension sector for the coming ten years. The result of this analysis is summarised in the form of four potential future scenarios.

Although in reality none of these selected scenarios is likely to play out exactly as presented, we can use these to show what disruptions and other effects may arise from current trends in demographics, the economy, society and technology. Irrespective of future developments, pension funds and administrators can already confidently take several steps or make preparations, without serious risk of regretting that in hindsight it was a wrong choice.

The aim of this paper is to provide ‘food for thought’ to stakeholders about the potential future of the pension system from a new angle or approach. We hope this will motivate all of those involved to ask fundamental questions about their own future in the pension system.

2 A PPI is a pension organisation based on the European Pension Directive, Institutions for Occupational Retirement Provision and focusses on defined contribution (DC) schemes. An APF is a pension provider that allows for the pooling of defined benefit (DB) pension plans of multiple pension funds.

2. The Dutch Pension System

The Dutch pension system has three pillars:

1. ***A basic pension founded by the general old age pensions act ("Algemene Ouderdomswet" or AOW).***
2. ***A pension scheme provided by employers based on time employed.***
3. ***Pension plans that are arranged individually.***

The government is responsible for the *first pillar*, the AOW. This is a basic pension available to all who have been Dutch residents at working age, and is non-means-tested for income or wealth. The AOW pensions are financed on a 'pay-as-you-go' or distribution basis, by premiums paid by the working population, with a supplement from the government.

Pension schemes in the *second pillar* are a condition of employment, and a responsibility of the social partners. Within fiscal boundaries, the social partners determine the contents of a pension agreement. Employees are generally represented by labour unions and / or works councils. The government establishes laws and rules to guarantee the pension agreements.

The *third pillar* consists of fiscally determined and facilitated by individual insurances for retirement.

In addition, people can generate an income at old age by means of work, returns on savings, rental income or by 'consuming' the surplus value of their houses.

The role of the government

With a legal framework, the government safeguards that employers will honour pension agreements they have made. The Dutch central bank (DNB) and the financial markets regulator ("Autoriteit Financiële Markten", AFM) supervise the pension sector. DNB in particular oversees the solvency of pension providers, including insurance companies. It also verifies the competence and integrity of board members. The main principles applied are:

- Pension agreements are from the start completely funded at a pension fund, a PPI or an insurer. A pension provider needs to invest prudently.
- Individual legal certainty is guaranteed by means of substantive requirements. Examples are rules for equal treatment, and the right of value transfer in case of a change in employer.
- Certainty of execution is provided by means of rules regarding the organisation of a pension fund, its management, stakeholder participation and communication related to pension schemes.

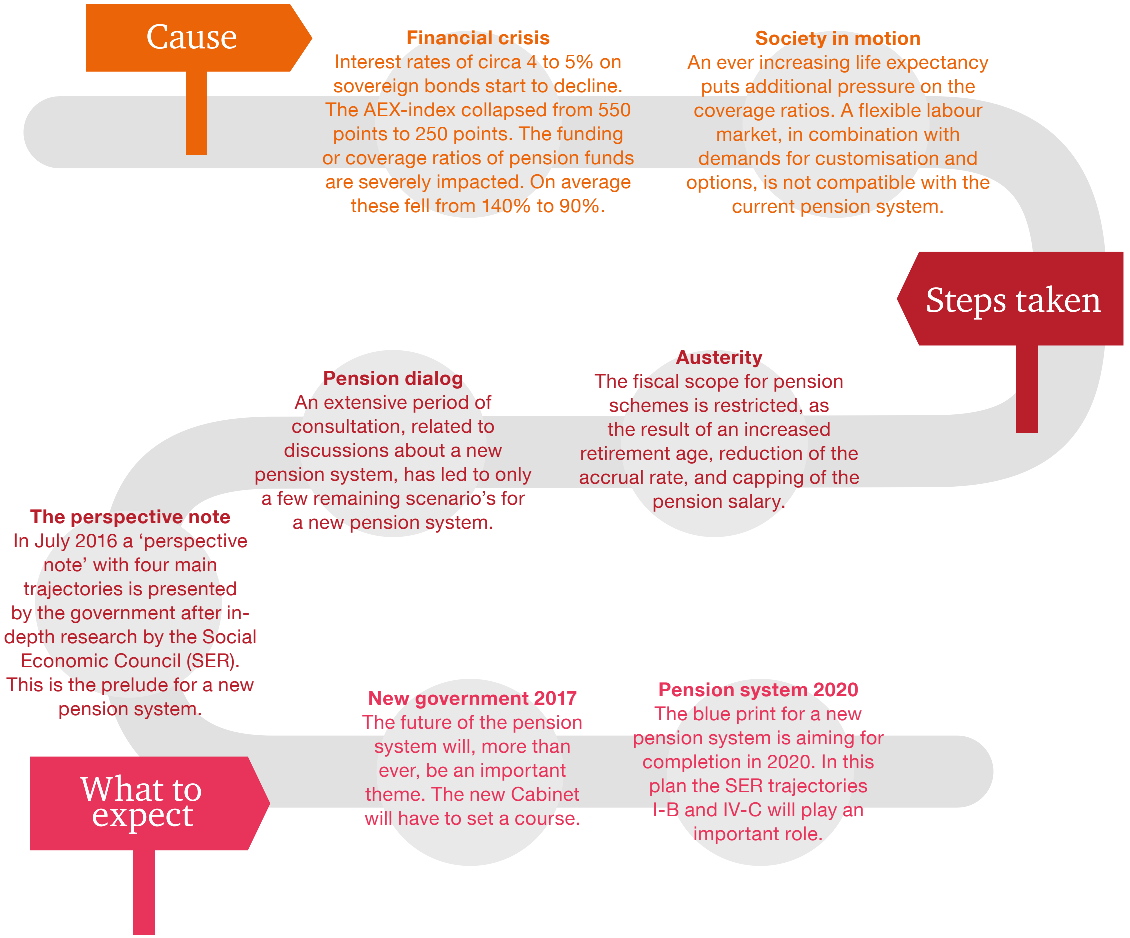
The AFM supervises the behavioural aspects of pension funds and administrators, in order to protect the participants in pension schemes.

The government also makes decisions with respect to the participation in the mandatory pension funds of particular sectors or independent professionals. (Henceforth, we will refer to this as 'mandatory participation'.[3])

Fiscal boundaries apply to pensions. Within these fiscal boundaries the so-called reversal-rule or EET-system ("omkeerregeling") is valid. This means that granted pension rights, i.e. assets, are not taxed (Exempt), the return on assets are Exempt but subsequent pension distributions are Taxed. There are also pensions without this EET-syste,, e.g. a net pension in the second pillar.

3 See also page 15 for some more details.

A long-lasting discussion



The role of social partners, pension funds, insurers and administrators

In the second pillar, the social partners – both employers and employees – organise a pension for an institute, a corporation or sector. The pension scheme is allocated to a corporate pension fund, a sector pension fund, PPI, APF or an insurance company. Pension administration and asset management can be executed by a separate organisation. Generally the employer(s) and employees are represented in the management board of their pension fund.

The role of social partners is changing. An APF or PPI does not need to be established and managed by social partners, and in practice this is rarely the case. However, at pension funds that have been formed by social partners, representation of employees and employers in management can change. Since 2013, governance models are allowed with management in which stakeholders are not, or are but to a lesser extent, represented as an alternative for the conventional models with representation of employers, employees and retirees. In this case, an independent stakeholder body exists with approval and advise authority.

3. Disruptors

Revisions of the pension system are only partly determined by political decision making. They are predominantly driven by the impact of megatrends on the pension sector.

"With the help of robotics more standardised processes can be automated, leading to significantly lower costs"

These consequences that are disruptive in nature, in our opinion, determine how the revision of the legal pension framework will ultimately be shaped, and what choices different parties will have to make. Several trends of the past years we can mention are:
- Demographic changes;
- Social changes;
- Low interest rates and stagnating economic growth;
- Technological progress;
- A changing role of the government, legislation and supervisors;
- Consolidation in the pension sector.

At least within the context of pension arrangements, we sort of know what kind of demographic developments to expect. The number of young people will diminish in comparison to older people, partly as a result of longevity. Pension distributions will continue for longer periods, and an increasingly smaller number of workers will be available to fund the on-going AOW-share. The government has partly addressed this last issue by raising the eligible pension age at which distributions will start.

In the case of the other trends mentioned the impact is harder to assess. We address this further below.

Social changes

Every generation is shaped by the times in which they come of age, and this results in different, age-dependent preferences of participants in pension schemes. Whereas older generations generally prefer to leave the management of their pension assets to collective pension funds, younger generations frequently wish to take responsibility themselves. The wish to be able to make choices, such as the option not to save for retirement in the second or third pillar. This generation also has a greater desire for information and modern, digital tools to facilitate individual decision making and efficient communication with their pension administrator.

The desire for individual freedom is also highlighted by the wish to work independently or flexibly, whereby working overseas is a plausible option. At the same time, more and more employers have become reluctant to provide permanent labour contracts. As a consequence, especially for the less educated, people are forced to work on a flexible basis. This makes it harder for them to buy a house, or to acquire alternative forms of social security. The accrual of pension rights in these cases, tend to differ from a person who is employed for a long time at the same organisation in their home country. The pension system is not always aligned with these emerging needs, and therefore has led to a louder call for change among younger people.

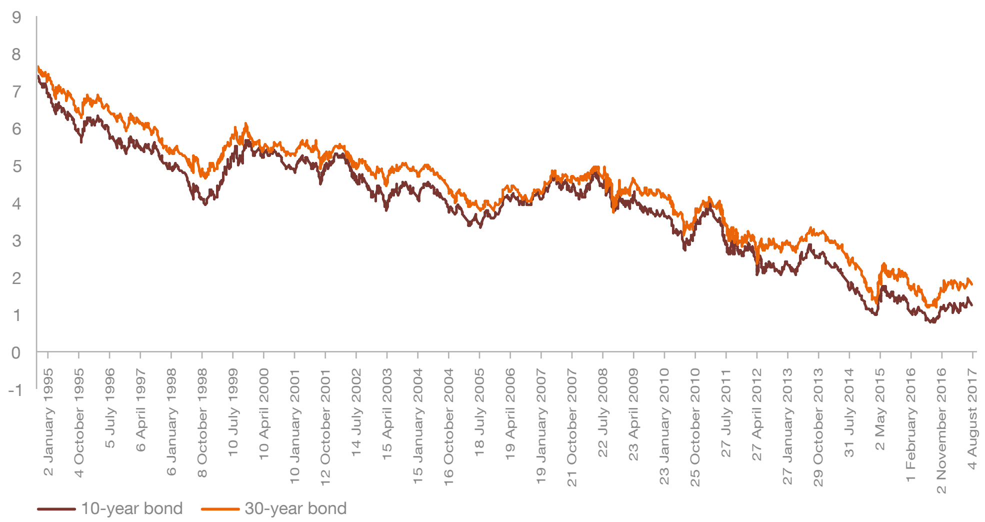
We also observe a decline of the support for the current, opaque form of solidarity, e.g. that among generations. Financial problems within the pension sector have raised questions about the correct way of calculating deficiencies, and how impacts can be allocated across different generations and categories of participants.

Among social changes, we also count increased labour immigration into the Netherlands, and a reduced trust in institutions, like pension funds.

Past financial-economic performance is no guarantee for the future

Europe has already been confronted with an aging population in recent years as well as a limited growth of labour productivity, strongly integrated international markets and a very loose monetary policy of central banks. These factors have lowered interest rates to such low levels, that pension funds have gotten into trouble. Pension funds need to value their obligations on the basis of current market rates, which have declined significantly in the past years to historically low levels.

Yield to maturity of Dutch sovereign bonds (in percentage), 1995-2017



Source: Reuters.

This requires an increase of provisions for the future payment of pensions, as they are only partly compensated by an increase in the value of fixed income instruments. Furthermore, pension funds need to take into account a longer life expectancy of their participants. The return on investments in equities is volatile, and as measured over a period of multiple years is currently lower than the historical average. The result is that coverage ratios of pension funds have declined to the extent that distributions are often no longer indexed and have in some cases even been reduced.

The worsening of conditions, and their impact, have raised many questions and led to discussions. Is it still realistic to guarantee a lifelong pension to workers? Is it fair to charge one generation in order to maintain the pension payments of another generation at the promised levels? Do stricter rules lead to more restraints, so that pension providers cannot adapt well to current circumstances?

Technology is enabling increases in efficiency

Technological developments have had an impact on the pension sector in various manners. Digitalisation and data analysis have enabled a more efficient execution of pension related processes with faster, more personalised information to participants providing them with support in making choices. These developments also allow for a more personalized offering through better alignment of pension products and services with customer needs. With help of robotics more standardised processes can be automated, leading to significantly lower costs.

"A reduction in funded pensions signifies less sensitivity of pensions for low interest rate levels"

We expect that with the help of robo-advice, straightforward advice related processes can be automated. The complexity of administrative execution will exceedingly be less of an excuse for not meeting participant demands.

More automation and digital technology also means that some professions will disappear as others are created. This may particularly have an impact on pension funds that are focussed on specific professions or sectors.

Changing role of government and supervision

The government is looking for a revision of the pension system that will do sufficient justice to all stakeholders, and that will be future proof in that it matches the requirements of an evolved society. This is turning out to be a lengthy and challenging process, and it is still not clear in which direction developments are heading. How, and to what extent the role of government and supervision will change is, as such, also uncertain. However, various trends make it likely that upcoming changes will at least be as significant as what we have seen in the past years, with the implementation of the financial assessment framework ("Financieel toetsingskader" or FTK), the increase of the AOW retirement age, new governance rules, fiscal changes, the €100,000 cap, the ability to continue investments with defined contribution (DC)-schemes and so forth. When for instance, current guarantees for pensions in the second pillar are partly or completely abolished, supervision related to this guarantee will also disappear, either partially or entirely. Another example with a great impact on government and supervision, is a wholly or partial abandonment of the mandatory participation.

A development that could enhance the role of government, is a shift from funded pensions to pay-as-you-go, for example, by raising AOW-entitlements. By doing so, the government would restrict further growth of pension assets relative to gross domestic product and allow for more financial stability at the household level.[4] A reduction in funded pensions signifies less sensitivity of pensions for low interest rate levels. Exposure to an aging population will, however, increase retirement benefits that need to be paid out. Management of this financial stability is a potential disruptor in the pension sector.

Fewer and fewer pension funds

Economies of scale are increasingly important for pension funds in order to reduce costs per scheme member and to meet demands concerning management, governance and operations. Smaller pension funds have already merged into larger pension funds, or transferred their pension liabilities to an insurer. Large funds have remained attractive due to this inclination to realise economies of scale. Existing defined benefit (DB) arrangements cannot easily be allocated elsewhere, given the time and effort required to transfer large collective pension schemes. Other players in the sector, such as insurance companies and more recently, PPIs as well as APFs, compete with the conventional pension institutions for those market segments that are capable of moving pension assets more easily.

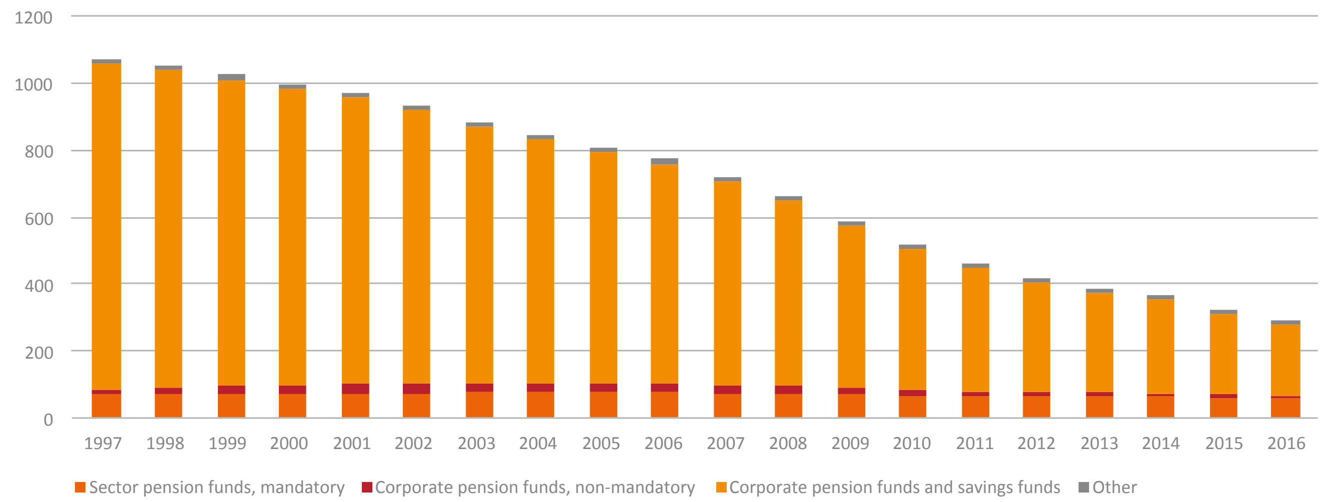
The economic position of PPIs and APFs is still relatively small in the market for pensions, but this can potentially change as a result of the observed trends, and possible changes in legislation. The mandatory participation plays an important role in this case. This concerns mandatory participation of employees in corporate or sector pension funds, and causes a large number of Dutch residents to save for retirement in addition to the state pension. A further relaxation of the mandatory participation can have consequences for the reach

4 The Dutch central bank (DNB) has conducted research on government policy concerning housing and pensions, and concluded that Dutch households are vulnerable to financial shocks. This results as a consequence of large pension and housing assets on the one hand, and high mortgage debt on the other. Household balances are very long-term in nature and younger households have limited access to discretionary funds. At a macro-level, this situation has led to economic disadvantages in, for example, times of housing price declines, and further restricts progress on the housing ladder.

of APFs, insurers and potential newcomers on the pension market. Competition will increase, and the number of possible choices for those who wish to save for retirement will likely increase too. Such a relaxation would also impact corporate pension funds with mandatory retirement schemes, and force them to adapt the organisation to changes.

Future revisions will have to address multiple important pension related issues. The necessity for this will remain particularly compelling as long as the economy does not rebound strongly and interest rates remain low. If economic conditions from before the global financial crisis return, revisions may stagnate or become insignificant, as the urge to change would dissipate.

Number of pension funds in the Netherlands, 1997-2016



Source: DNB.

4. Scenarios

In our opinion, the opposites 'collective versus individual' and 'low interest rates, weak economy versus high interest rates, strong economy' to a large extent determine future developments in the pension sector. We have therefore chosen four future scenarios along two main axes that represent these opposites.

The socio-cultural axis runs from *'collective'* to *'individual'*, and concerns society's orientation with respect to the degree of collectivity and solidarity between groups of residents, employees, generations and nationalities. This is reflected in the design of the labour market, social security and the pension system. It is further mirrored in the use of social media, health care and the experience of leisure within the context of associations and clubs.

The economic axis runs from *'low interest rates, weak economy'* to *'high interest rates, strong economy'*. A strong economy can for some time coincide with low interest rates, but we have chosen for correlations that in the longer term are mostly aligned with prevalent economic theory. The economic indicators interest, inflation and growth show coherence within a longer time frame.

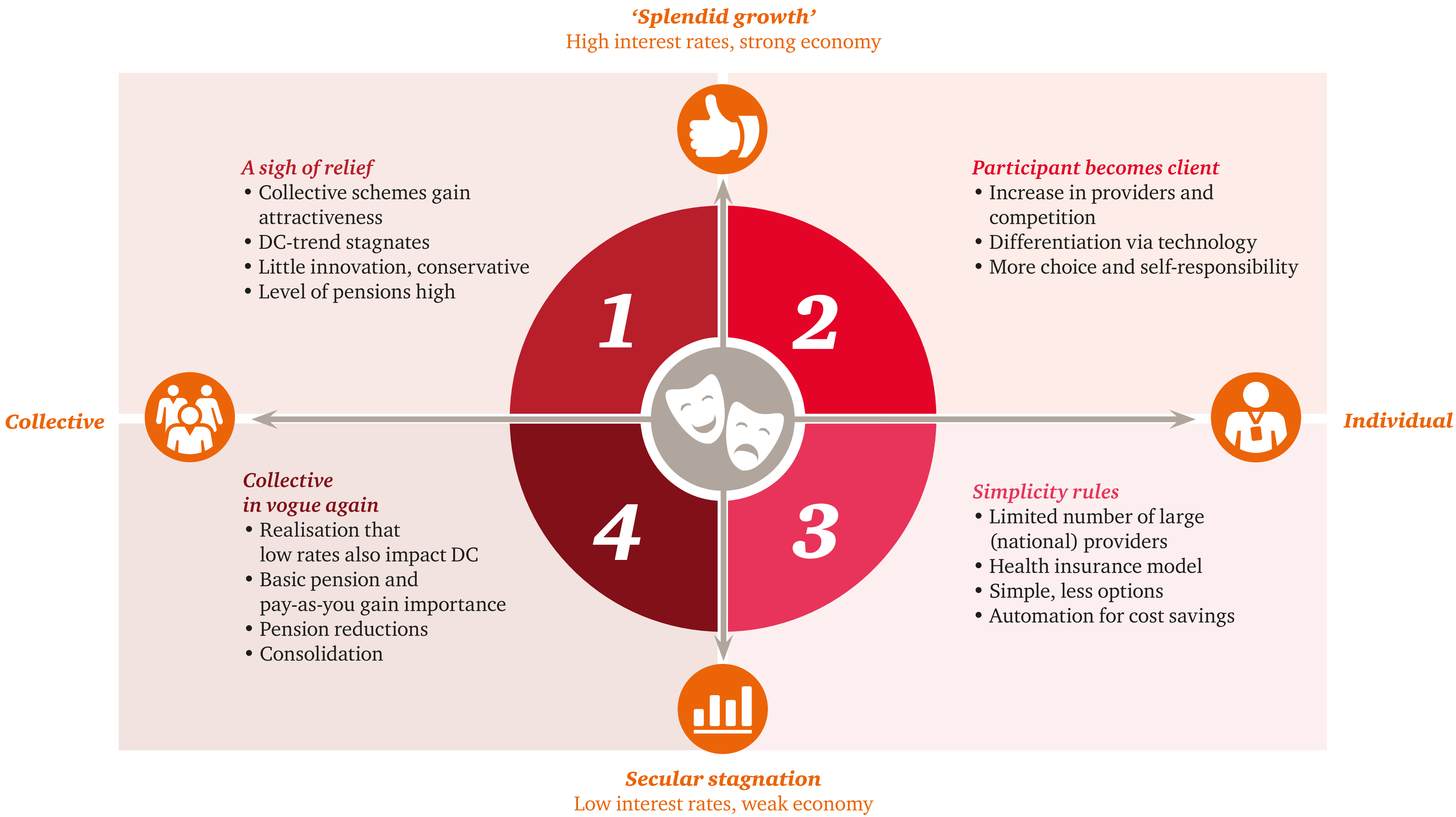
In order to stimulate economic growth, the central bank has already maintained a loose monetary policy for several years that has led to low interest rates. In combination with the already prevalent structural pressures on inflation from international economic relations, this has resulted in an increase of pension liabilities with double digit percentage points. Not only in case of pension funds, but also at companies reporting under IFRS.

Pension funds saw their coverage ratios decline, and responded with reductions of annual indexations and nominal pensions. This resulted in discussions about the affordability of benefit schemes, and the transition to another pension system with a capital distribution, rather than retirement distributions.

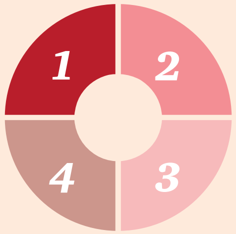
Our approach with these scenarios aims to point out different future developments and their potential impact on the main players in the pension field. As such, it does not concern forecasts or recommendations.

Given their purpose, the scenarios do not need to be mutually consistent, and are not. For instance in one scenario, economic prosperity will lead to a greater demand for personalisation with many choices, at the cost of the collective system. While another scenario describes that economic prosperity will weaken the objections against the collective system, so that collective arrangements remain a dominant form of pension scheme.

Four scenarios



Scenario 1
“A sigh of relief”



After a few prosperous years, real interest rates are already for some time higher than the economic growth rate. The coverage ratios of pension funds have improved swiftly, and the indexation of retirement benefits is no longer a problem. Pension funds further have sufficient buffers to withstand an unfavourable period.

Objections to collective pension schemes, such as issues with indexation or the distribution of pension benefits without reductions, and a lack of transparency with respect to entitlements, disappear to the background. Advantages, such as inter-generational risk sharing and a long investment horizon, come to the foreground again. Participants once more support the well-known collective schemes, which as a result, remain the dominant form of retirement plan. The wish for a move to DC-schemes diminishes.

Individual DC-schemes only marginally grow. Collective DC-plans (CDC) are considered to be an attractive, hybrid-like alternative for DB-plans. The transfer from DB-plans to CDC-plans is more common than that from DB to individual DC-plans.

The government implements only limited adjustments, like the abolition of the average premium method and the introduction of a system of degressive accrual, in order to secure the sustainability of the collective system for the longer term. In the sector, the necessity to consolidate is waning. Smaller pension funds more easily manage to survive, although with different forms of management, due to a decline in the availability of qualified people in affiliated organisations that meet stricter requirements. Obviously, there is natural attrition of pension funds e.g. as a result of the termination of activities by affiliated companies. The interest in APFs is declining as well.

The solidity of established pension funds prevents new entrants from entering the pension market. The traditional pension funds are hardly pressured to change, and as a result, much remains as it is. Pension funds and administrators generally behave in a conservative manner, and are barely encouraged to invest in innovation. Products and organisations evolve gradually, with a focus on maintenance, not renewal. Investors, advisors and external managers or experts do, however, innovate. These parties compete with each other, and by means of development and improvements, aim to differentiate as well as improve positioning.

Although changes in the pension sector are limited, as a consequence of the strong economy and high interest rates, some developments continue unabated. The labour market continues to differentiate. Other kinds of jobs come into existence, start-ups grow and in nascent sectors collective arrangements are established that do not readily fit in the traditional pension system. This means that old sectors and pension funds shrink or need to adapt to remain relevant.

Scenario 1 “A sigh of relief”

Another effect of the improving financial environment, is that pension funds are better able to invest more in relatively risky assets with higher expected returns. Investments in private equity, venture capital, emerging markets and direct investments in long-term projects, such as infrastructure, are (again) a viable option. Once more, pension funds at least partly hedge risks. Higher coverage ratios, in combination with ‘lessons learned’ from the past, will direct the policy of pension funds increasingly to hedging real interest rate risks.

Authority and profits remain largely with existing, traditional parties. Among these are the social partners, fund boards and administrative organisations. They keep their dominant position and influence. They further perceive few immediate reasons for adjustments and revisions. For newcomers, the realisation of economies of scale - which the larger established parties already have - are a difficult barrier of entry to overcome without opportunities in the form of far reaching revisions of the pension system.

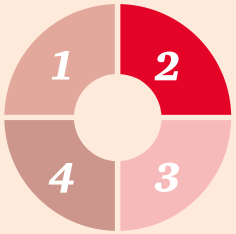
As a result of the strong economy, the government no longer sees a great need for stricter regulation of the pension sector, nor interference in the social partners as their role. Therefore, much is left to employers and labour unions to work out. These parties are familiar with the conventional collective plans, mostly managed by a pension fund.

Only when the annual pension costs are high or uncertain, do fundamental questions about collective pensions get raised by employers. Alternatively, questions may be raised when a pension fund is unable to realise the aims of a pension plan leading to disappointed employees. In a strong economy with high interest rates, this does not apply, and there is a certain degree of complacency.

Due to favourable financial conditions, pension funds no longer feel under pressure by supervisors. Social partners have sufficient influence to counterweight individualism, by successfully promoting the benefits of collective pension arrangements. Issues related to the abolition of the average premium method have, however, remained. As a consequence, the government supports an amendment in the form of a degressive accrual.

Political support for collective DB-plans has always remained large, as these are considered solid and righteous. The strong economy and high interest rates have improved the financial position of pension funds, leading to a resumption of indexation. Partly due to this, and for the time being, political favour, support for individual pension plans fails to materialise.

Scenario 2 “Participant becomes client”



After years of weak economic growth, the Dutch economy is faring well again. Unemployment is at its lowest level in recent history, incomes and prices are rising, turning the fear for deflation into something of the past. Due to these developments, interest rates have risen. The coverage ratios of pension funds have made a successful upturn.

The favourable economic circumstances remove the final reservations regarding the risks of individual pension plans. A growing number of workers want greater self-determination, more choice and increased transparency. DC-plans and additional gross or net plans gain interest and various providers of these products are able to increase their share in the pension market. The government facilitates these developments with new legislation. For instance:

- Rules pertaining to care of duty of individual pension product providers - an increasing number of plan members no longer belong to a collective, in which choices are more or less made for them. Individual retirement schemes can be too complex, so that without specific knowledge a responsible decision cannot be made.
- Amendments to the ‘independent professionals without employees’ (“zelfstandigen zonder personeel” or zzp) framework, in which the mandatory participation, a minimum level of pension savings and fiscal boundaries are established. In case of a shift to individual pension plans, measures are required to ensure that large numbers of people have adequate retirement savings.
- Abolition of the ‘large’ mandatory participation, and potential end to the ‘small’ mandatory participation. The small mandatory participation concerns mandatory participation of employees in the pension plan of their employers. The large mandatory participation relates to a ministerially enforced participation in the pension fund of a sector. The abolition of the large mandatory participation is an important stimulus for DC-plans, because employers and employees will subsequently get the liberty to select their own pension provider and pension scheme. Another possibility is that mandatory participation in a certain sector pension scheme will be dropped, while participation in a specific pension scheme will remain intact. Growth of DC-plans will take place to a greater extent, if additionally the small mandatory participation is terminated as well. This, as even more people can select their pension plan and provider.

Due to the transformation from collective to individual, new opportunities arise for insurance companies and PPIs to expand their market shares. Asset managers and newcomers will be able to enter the market with help of advanced digital solutions. Market participants use technology for differentiation of products, personalised marketing and cost control. In particular those organisations that are strong in customer focus, have compelling personalised service offerings with data analysis and high levels of automation, or organisations that in time are able to realise this to a great extent, will be well positioned. New entrants to the pension market and foreign institutions will be among those well positioned parties, as outstanding technological qualities will have greater distinctive value than knowledge of local pension schemes. After all, this expertise can quite easily be hired. As long as organisations that launch new products do not take over legacy-obligations, they further hardly need historical pension knowledge. Besides this, DC-schemes are similar to existing products for private investors, in which much experience has already built up.

The significance of collective plans diminishes, and traditional pension organisations are pressured to review service offerings, organisational structure and systems. For this, employees with different competencies are required, like commercial skills with a focus on personalised solutions for individual end users. Change management and digital applications are crucial in this trajectory. Market influence and profits are bestowed to the most innovative parties, that most swiftly and effectively align with various customer needs. Insurers benefit from the shift from collective to individual, but may be held back by an inhibiting structure, consisting of outdated software and systems. If this is not resolved, the chances for success will be limited. PPIs are already set-up for the provision of individual pension plans with low cost structures and high degrees of transparency. As such they are well positioned for a scenario in which pension plans for individuals thrive.

Individual responsibility for retirement increases. As a result, advisory services appear that support individuals or small groups. Also in case of these services, technology plays an important role in helping people with the personalised options of pension products and providers. Apart from pensions, other financial matters such as wealth management, income and property are also taken into account. The role of an intermediary or advisor is restricted to a relatively small number of

Scenario 2
“Participant becomes client”

complex situations for which automated support is insufficient. A hybrid form of financial advice will come into being, with robo-advice for simple standard situations, alternatives such as text or video chat for somewhat more complex advisory services, and face-to-face consultations for the most complex cases.

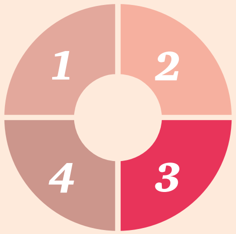
Asset managers and IT-enterprises that develop an intermediary-like role can ,thanks to technology, become more significant players in the pension sector. For instance, by deploying automated advice and communication tools, and the digitalised provision of risk insurance. Large established pension providers respond to this by presenting themselves as expert organisations, providing advisory services in combination with more options in collective pension plans, or complementary products. Further, new and potentially non-domestic organisations with a focussed strategy, have an opportunity to gain a strong position. The combination of high quality and low costs is essential, resulting from the automatization of administrative processes.

Employers benefit from sound pension products for their employees. This is an advantage for the labour market, and reduces the risk that employees and their relatives are confronted with financial problems, while still connected to their employer. Employers therefore, preserve control over the selection of pension providers. Labour unions and comparable organisations play a smaller role, due to an increased workers’ need for self-determination – matching the trend of an individually focussed society – and reduced interest in collective arrangements.

After the abolition of the large mandatory participation, the number of pension funds offering DB-plans dwindles further. Only those funds that are able to switch in time to an organisation capable of offering basic plans competitively, supplemented with individually focussed modules, will be able to continue independently. Pension funds that are unable to adapt properly, will in many cases need to merge with more successful funds, or liquidate.

Due to the transition from collective to individual, the manner in which pension assets can be invested also changes. With respect to investments and risk management, not everything that is possible within the context of collective plans can be replicated in individual schemes. For example, collective pension funds can invest directly in corporations or projects for many years, while individual investments largely need to be organised via collective investment undertakings. As a consequence of the free choice of pension provider, the opportunity exists to switch provider during the lifetime of a plan. For this unrestricted market, it is more attractive to invest in securities that offer flexibility and transferability. In general, the investment horizon becomes shorter in the case of individual pension schemes, and these plans are more strongly focussed on tradeable investment instruments such as bonds, shares and mutual funds. If switching pension providers is possible, individual investments need to be easily transferrable which limits the individual investment options. An initial issue is also the complicated conversion of DB-plans to DC-plans.

Scenario 3
“Simplicity rules”



Things are not so bad, but economic growth is not at the same level experienced at the beginning of this century. Inflation is low due to limited economic activity and modest surplus capacity. As a result, interest rates have hardly risen. The relative share of the non-active population has increased, and labour productivity is not showing positive dynamics.

Consolidation in the pension sector continues. Only a few newcomers enter the market so that the total number of pension providers is declining. Much attention is paid to cost control, in order to be able to invest in adjustments. Pension administrators apply technology to automate processes to a greater extent, reduce costs and to acquire synergy benefits.

DB-plans are perceived as complex, opaque, costly and uncertain. Returns on investments are relatively low, and life expectancy is rising, resulting in increased pressure on the coverage ratios of pension funds with DB-schemes. Allowances to follow price developments are scarcely provided, discounts of 10% on pension accruals and claims occur. Participants are dissatisfied, and no longer want collective pension plans. They want to get a better grip on their old-age provisions and hope to secure these. Social partners actively look for alternatives. Demand is met by competing parties, that mainly provide more-or-less similar individual basic offerings. The cause for this limited supply is twofold: cost considerations and the realisation that the generous pensions at the level of around the beginning of this century, are no longer achievable.

The remaining collective pension schemes choose a hybrid solution: one part is DB, and another part is a pension plan without guarantees. Pension contracts under which many individual DC-plans fall, particularly end up with a small number of large pension institutions, that are capable of achieving economies of scale. This also applies to ‘closed book’ pension funds, for which insurance companies seek a low cost solution.

When pension funds merge, synergy benefits are greater than they used to be in the past, because diversity has diminished and organisations work with standardised solutions. The consolidated organisation is simpler, with hardly any similar functions and departments co-existing after the merger. Offerings too are more straight forward compared to the past. Options that are low in demand, soon disappear, as they are too costly.

Besides pooled pension plans, with many participants and accommodated by a pension administrator, there are individual pension plans whereby the participant determines which administrator will look after the plan. For this category, a health insurance model is created for DC-plans, offering a similar degree of standardisation, range of options and risks. Several distinctive pension providers focus on people who can freely choose a pension provider or wish to supplement an existing (underfunded) retirement scheme with a DC-plan. The government functions as a market superintendent, and arranges a potential acceptance obligation. In this scenario a reduction of the cap, i.e. the income level above which no mandatory pension contributions are made, fits in.

Scenario 3 "Simplicity rules"

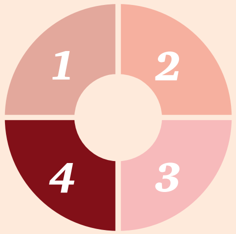
As a consequence of the individualisation of pensions and standardisation of products, a transition system comparable to that of energy suppliers comes into existence. Although a switch-over system for DB-schemes is feasible, it does not get off the ground because of complexity. The possibility to switch from one pension provider to another has considerable consequences for investment characteristics. In comparison to collective schemes, the investment horizon of individual plans becomes much shorter. Additionally, individuals hunt for higher yields. This provides opportunities for dubious providers promising high returns, unless sufficient regulation and protection is put into place. Duty of care needs to ensure this.

The basic pension is a financial product. The possibility of legal conflict increases, as a consequence of individual agreements, switches and disappointing results. Specialist legal services benefit from this trend.

The largest pension providers see their market influence and profits grow. They enjoy economies of scale due to their size, while the agility in product development of smaller parties adds little value in a market of standardised products. The large organisations take advantage of beneficial market developments to enhance efficiency, without losing ground during the transitory stage that they would otherwise have to regain afterwards.

More than in the past, new technology is used to improve administrative processes, data management and communication with participants. This means that an organisation can resolve a lag in the implementation of technology, and the prevalence of non-optimal parts of operations, by means of a coherent and focussed change process. Besides this, the large pension institutions outsource activities to specialised service providers in order to keep the cost levels in their organisation low.

Scenario 4
“Collective in vogue again”



After several years with economic growth picking up, the trend falters. Due to a very limited increase in productivity and surplus capacity, economic growth and inflation remain below the long-term average. Interest rates are persistently low, and security markets move sideways rather than upwards.

Because of continuous low interest rates, DB-plans are increasingly unsustainable. Trust in the existing pension system is low, and the call for fair and realistic alternatives persists. At the same time, research and comparative forecasts demonstrate that a collective pension system leads to greater wealth in comparison to a system with individual pension plans. An division of costs and benefits, done as fair as possibly, within the collective system, is however a requirement to prevent a disproportionate advantage or disadvantage for certain groups.

Individual DC-plans are increasingly perceived as risky and non-optimal, also by young persons and independent professionals. People realise that pension ambitions from the past were not sustainable and more strongly believe that disappointments were the result of factors such as higher life expectancy, lower interest rates, a weaker economy and stricter buffer requirements, rather than the collective system itself. These factors have put the financial position of companies under pressure as well, and with this, the willingness of these companies to improve the funded status of their corporate pension funds.

The role and influence of the government expands in order to guarantee pension arrangements. The government is also the driving force behind the transition to a small number of pension providers, with collective pension schemes of a relatively simple design. This with the aim to make the pension system more resilient and sustainable. In an extreme case, it is possible to think of a nationalised pension fund, in which a part of current providers are absorbed, with a further reduction of the income cap.

From this situation, a shift is initiated from funded pensions to pay-as-you-go retirements, or general provisions as an alternative for pay-as-you-go. The purpose of this is to prevent costs being rolled over to future generations. The first pillar gains in importance, at the expense of the second pillar. Relatively small numbers of employees need another form of pension. Such schemes are allowed for a selection of income groups.

Organisations in the pension sector consolidate under pressure by economic conditions and the government. In new pension products and related communication, providers take into account uncertainty, low economic growth, low interest rates and demographic changes. Only large organisations, that adopt modern technology, have a broad focus and relatively simple, standardised pension offerings, will remain. Technological applications consist of ongoing automatization of operational tasks, robotisation of the back office and the use of social media to inform participants about their pensions.

The winners are those organisations that are part of the consolidation, or the national pension fund. At a smaller scale, the benefactors are those parties that have successfully met the need for other kind of pension plans. This last segment is niche, with relatively attractive profit margins.

5. What do these scenarios imply for the pension market participants?

It is uncertain how the Dutch pension sector will evolve in the coming ten years. The impact of changes can further be quite different, depending on the type of organisation. How can an organisation best cope with change? This can only be responsibly answered after an analysis of the market its future, as well as current conditions and characteristics. Scenarios help with such analysis, by verifying what can happen to an organisation if these scenarios become reality.

Regardless of the future scenario, organisations can contemplate changes that will in any case add value. In our opinion, taking into account the following aspects will contribute to this.

Technology

Technological progress has enabled extremely fast collection and processing of (large amounts of unstructured) data and new forms of communication. By far not all possibilities are applied, and that is understandable. The fast development of technological capabilities in operations, confronts pension funds, administrators and insurers with the question to what extent outdated systems need to remain in use. It is not without risk to make a switch from legacy systems to the newest standards. Additionally, in general technology has continued to evolve quite a bit, once such a transition has been implemented.

Notwithstanding, if organisations have the ambition to play a major role in the future pension market, they will have to work on, and with, technology. This applies to both providers of collective DB-plans, as to those offering individual DC-plans. It seems we are currently in a stage in which differences will be made. Organisations that in the coming years make relatively significant efforts to innovatively improve their use of technology, will benefit from this in the longer term.

New entrants to the pension sector from the technology sector, or advanced asset managers, are generally very well capable of using the latest technology to their advantage. They are not held back by legacy systems, have the right internal expertise and are customer focussed. Technology is a larger challenge for the established parties in the pension sector, and particularly those organisations that have not, or scarcely, the possibility to deploy new technology within a short period of time. This kind of organisation might benefit from collaboration with technologically more advanced companies, which on their turn, wish to gain economies of scale. One can think of constructions in which technologically advanced partners share activities, such as administrative tasks or customer contact, under the name or brand of the established organisation.

Trust in the sector

Irrespective of the developments the Dutch pension sector will go through the coming years, participants' low degree of trust will play an important role. This lack of trust has undesirable consequences for the functioning of the sector in all segments and scenarios.

An important cause for the loss of trust, is that expectations regarding pensions did not prove to be true and pension related pledges were not fulfilled. The transition from final pay schemes to average pay schemes was still accepted, but lagging indexation and even cuts in pensions, led to concerns that have not yet been alleviated. How could it come that far? The often very critical approach of journalists, interest groups and individuals, focusses on the policy and actions of both the social partners and pension funds, as well as supervision. The exogenous causes of the pension crisis received far less attention.

Although it is in the interest of the whole pension sector to restore trust, separate pension funds, pension administrators and insurance companies can distinguish themselves, providing they are willing to let go of hitherto usual, albeit non-optimal, approaches. Besides this, all parties can benefit from collaboration or mutual consultations in order to improve the reputation of the sector.

Established providers of collective plans will have to clearly communicate information concerning costs and results to participants. A provider should regard a group as separate customers, and treat them as such. The personalisation of communication is increasingly possible. Other sources of income, apart from pensions can also be drawn on. The financial strengthening of the organisation in good times, so that adverse times can be better dealt with, with the avoidance of cuts and alike, is also of significance to regain and maintain trust. Free sector providers, such as insurers, PPIs and APFs, are given their existing business models, better able to gain or strengthen trust by means of a swift adaptation to customers' information needs. It can also be that they, as relatively new parties, enjoy insufficient trust and must work harder to gain this trust by deploying the before mentioned tools and approaches. Collaboration with respected organisations can be beneficial too.

Make it more attractive

When participants in a pension fund hear something about their pensions, it tends to be disappointing in nature (too little funding, cut backs, no surcharges etc.), difficult to comprehend information (e.g. in the annual pension statement), or at best a neutral notification. The media mainly refers to low coverage ratios, a lack of transparency, high costs, unfair risk allocation between young and old, as well as other problems related to pension funds.

The customer approach of successful companies, such as Google and Instagram, is completely different. They make it easier and more fun creating triggers and stimulating desired behaviour. Obviously, their products are different too, but much can be learned from their ways of working. Pension related communication can be more direct, faster, more attractive and especially, more personalised than before. Numbers, preferences, surveys, results etc. concerning pensions, can be presented in an engaging and interactive manner. Right at the time of an important event in someone's life, appropriate information can be provided about consequences or possibilities. Pension providers can adjust means of communication and language used, on the basis of participant characteristics. It is not only information itself, but also the way in which participants perceive pension related topics. The current attitude, that is strongly directed to reducing risks, must change into one focussed on opportunities.

For established parties, that because of the mandatory participation can be confident of their market shares, and still heavily rely on DB-plans, such a required change and alternative customer approach will be challenging. It asks for a 'business-to-consumer' attitude, and large investments in people, technology and culture. This will be easier for organisations that are already focussed on an end-user, like insurers and PPIs, and more adept at offering DC-plans as well as the use of new technology. This even more applies to new entrants to the pension sector, such as IT companies, FinTech start-ups and independent asset managers.

Pension organisations are confronted with important questions about their future, in a sector that will go through rapid changes in the coming years.

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