Pension 2025

Scenarios for the future of the pension sector

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Introduction: PwC’s pension consulting network

2,500 pension specialists across 32 countries; 250 specialists in the Netherlands

Global market leader in DB consulting and strong in DC consulting

Wim Koeleman

- Impact Center for Retirement & Pensions in EMEA region
- Global pension fund lead
- Based in Amsterdam
- 30 years experience in pensions

Ageing populations, low interest rate and volatile markets force governments and corporates to review pension systems and schemes

Demographics
developments / ageing populations

Growing liabilities
of pensions on corporate balance sheet and pension funds and insurers

Labour markets
are changing to accommodate societal evolution

Sound policies
on social security and tax systems including debt reduction after financial crisis

Savings
as source for investments opens up a broad spectrum of R&P possibilities

Technological disruption
causes new business models to arise and customer expectations to shift

Governments
Sound pension systems, social versus affordable

Corporates
Reduce pension risk versus providing solid pensions

Financial services
Current and new providers across the FS spectrum

New Products & Services
Pan European Pension Products and funds, Pooling

2

Dutch pension system

Three pillar system: state, employer and individual pensions

Balanced & shared responsibility

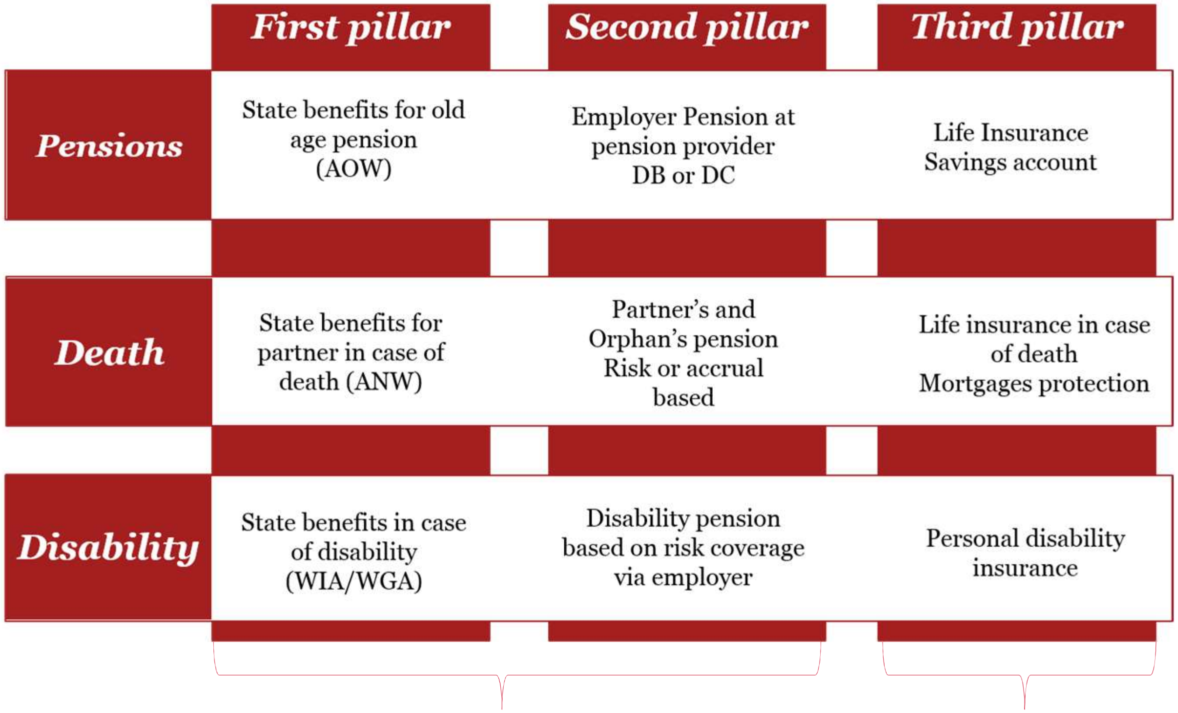
1. The state provides a minimum level of income for each inhabitant depending on years living in NL. Not related to income or capital for old age.
2. Employers provide supplementary pensions, organized per industry or company or group of professionals, depending on years of service and income level. Accrual is tax deductible up to gross income of €107,593 (2019)
3. Individual extra savings / insurance

Financed differently

First pillar: pay-as-you-go. Paid out of contribution and general tax income

Second pillar: Capital based. Financed by contributions and investment returns. Pension capital outside company (pension fund, insurance company).

Third pillar: On individual basis. Financial product (insurance, savings account). Financed by contributions and investment returns.



	First pillar	**Second pillar**	**Third pillar**
Pensions	State benefits for old age pension (AOW)	Employer Pension at pension provider DB or DC	Life Insurance Savings account
Death	State benefits for partner in case of death (ANW)	Partner's and Orphan's pension Risk or accrual based	Life insurance in case of death Mortgages protection
Disability	State benefits in case of disability (WIA/WGA)	Disability pension based on risk coverage via employer	Personal disability insurance

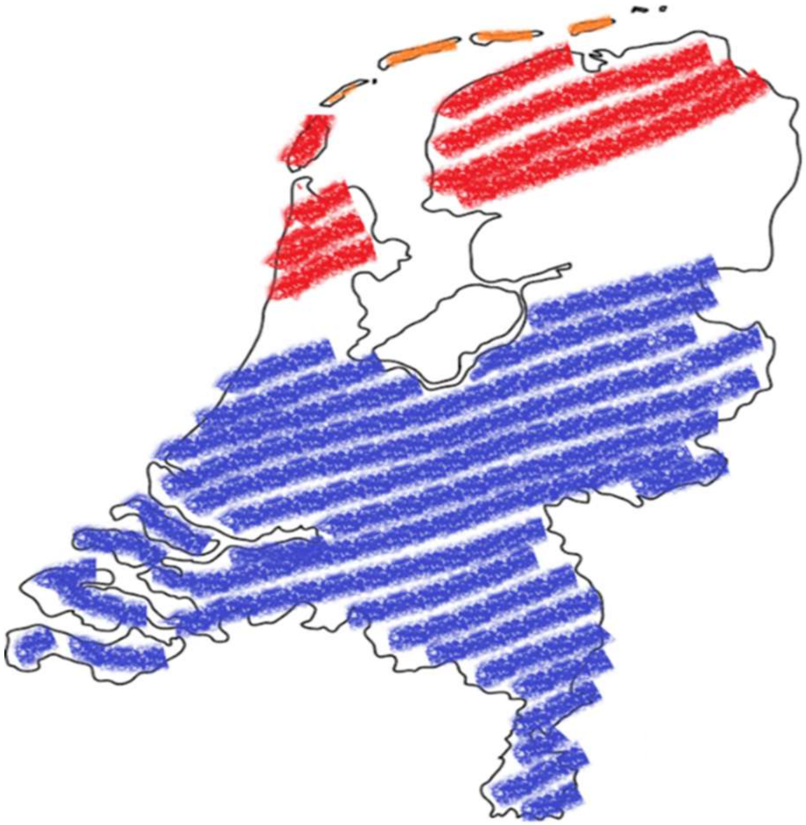
Beneficial tax regime

Lower tax rate after retirement than during accrual
No wealth tax

Wealth tax

Payable immediately and
no tax benefits

In the second pillar, multi-employer plans are dominant



13% **No pension plan**

- No legal obligation to provide retirement benefits in The Netherlands. Semi-mandatory in industries

15% **Insured benefit**

- The number of employees in DC plans at an insurer has increased from 4% to over 50% between 1995 and 2016
- New DB plans are likely to be funded through APF

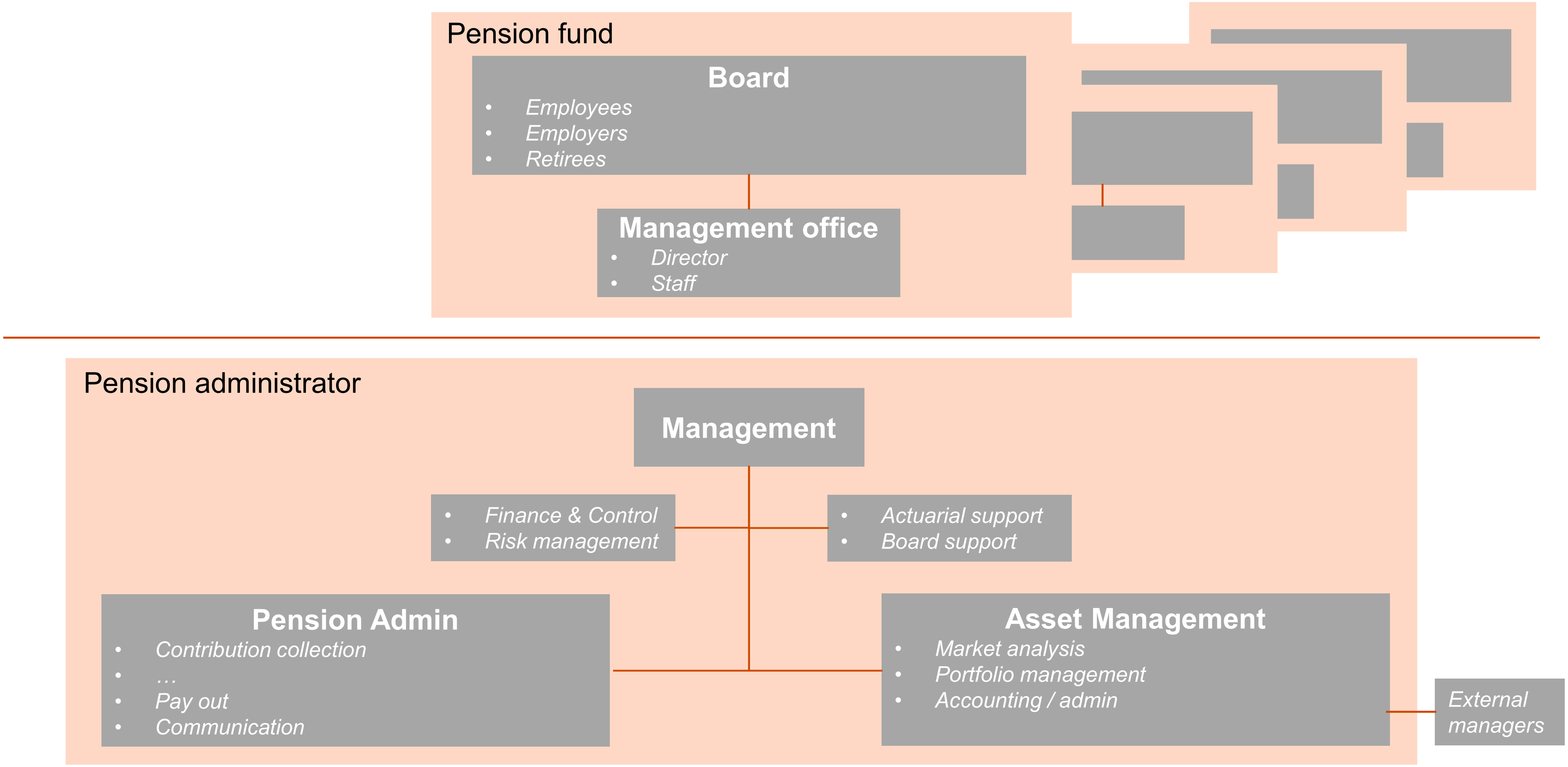
8% **Company pension fund (OPF)**

- Mainly for large companies with long history
- Significant decrease in number

64% **Multi-employer plan (BPF)**

- Mandatory, industrywide funds; organizations of employers / employees
- Currently around 60 pension funds, widely varying in size, up to €400bn
- 90% have average pay plan, participants bear majority of risks

Multi-employer plan organized in industrywide pension fund



Pension fund

Board

- *Employees*
- *Employers*
- *Retirees*

Management office

- *Director*
- *Staff*

Pension administrator

Management

- *Finance & Control*
- *Risk management*

- *Actuarial support*
- *Board support*

Pension Admin

- *Contribution collection*
- *…*
- *Pay out*
- *Communication*

Asset Management

- *Market analysis*
- *Portfolio management*
- *Accounting / admin*

External managers

Defined benefit plans are dominant in the market …

€ billions	Defined Benefit			Defined Contribution		
	Annual Premium	**Assets**	**Active participants**	**Annual Premium**	**Assets**	**Active Participants**
Total market	***31.5***	***1,251.5***	***5.671***	***3.6***	***33.7***	***1.191***
Industry funds	23.9	949.9	4.719	0.3	1.5	330
Company Funds	4.8	247.9	394	0.2	4.2	88
Other funds	0.5	25.3	55	0.0	3.5	9
Insurance comp. (*)	2.3	28.3	503	1.9	17.8	423
PPI	n/a	n/a	n/a	1.2	6.7	341

(*) figures estimated

Source DNB Q3 2018

DC part slightly underestimated; combination contracts included in DB

97% *of assets is related to DB*

86% *of DC market (premiums) is serviced by Life Insurer or PPI*

10% *of premium is DC*

83% *of actives participates in DB*

… but pension system reforms lead to fixed contributions

	Collective approach *I-B* **DC with direct conversion of premiums**	**Individual approach** *IV-B* **Individual DC until retirement age**
Premiums	Age independent premiums	Age independent premiums
Investments	Collective, uniform asset mix[1]	Individual lifecycle[2] during accumulation and collective during decumulation
Buying annuities	Direct conversion of premiums to accrual on deposit. Conversion rate is conversion rate neutral (RTS + UFR) [3]	Conversion on retirement age. Conversion rate is conversion rate neutral (RTS + UFR) [3]
Indexation	During accumulation and decumulation: (CR-100%)/10	During accumulation and decumulation: (CR-100%)/5

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[1] Implicit lifecycle.

[2] This lifecycle can be shaped based on a collective portfolio of age dependent return allocation (making illiquid asset classes possible)

[3] Coverage rate assumption is 100%

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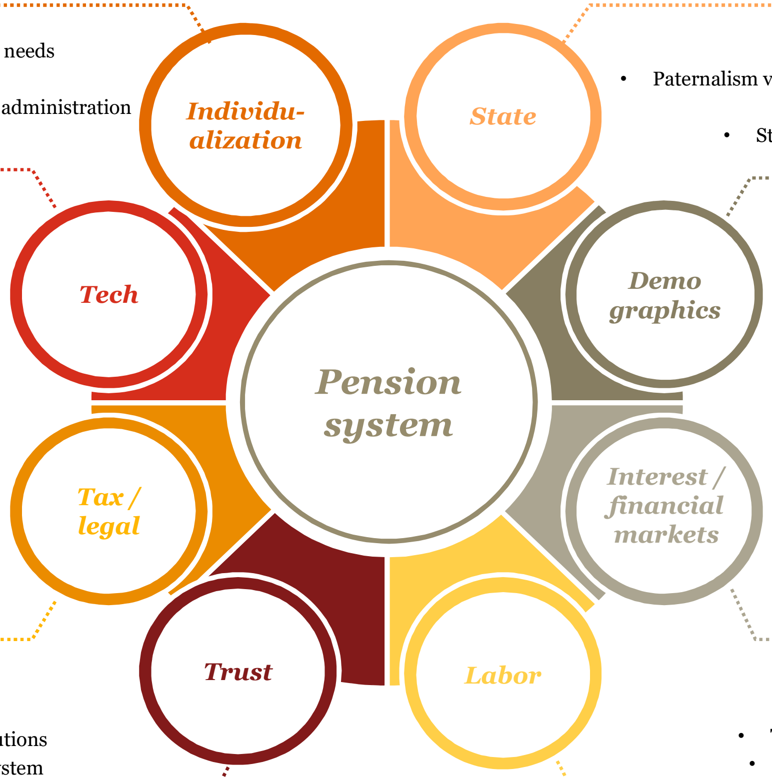
Scenario planning

Pension system under pressure due to economic, demographic and social developments



Individualizing society
- Own choices / different needs
- Critical of solidarity
- Diversity / flexibility in administration

Policies, priorities
- Civil society
- Paternalism versus individuals own responsibility
- Protection against poverty
- State current account deficit / surplus

Digitalization raises the bar
- Fast technological developments offer possibilities to accessible mass contact (use smart phones, social media) and drastic cost reductions
- Other sectors offer example
- Safeguard cyber risks

Population trends
- Increased life expectancy
- Growth in pensioners
- Lower fertility rates
- Working longer
- Equality / inequality of men - women

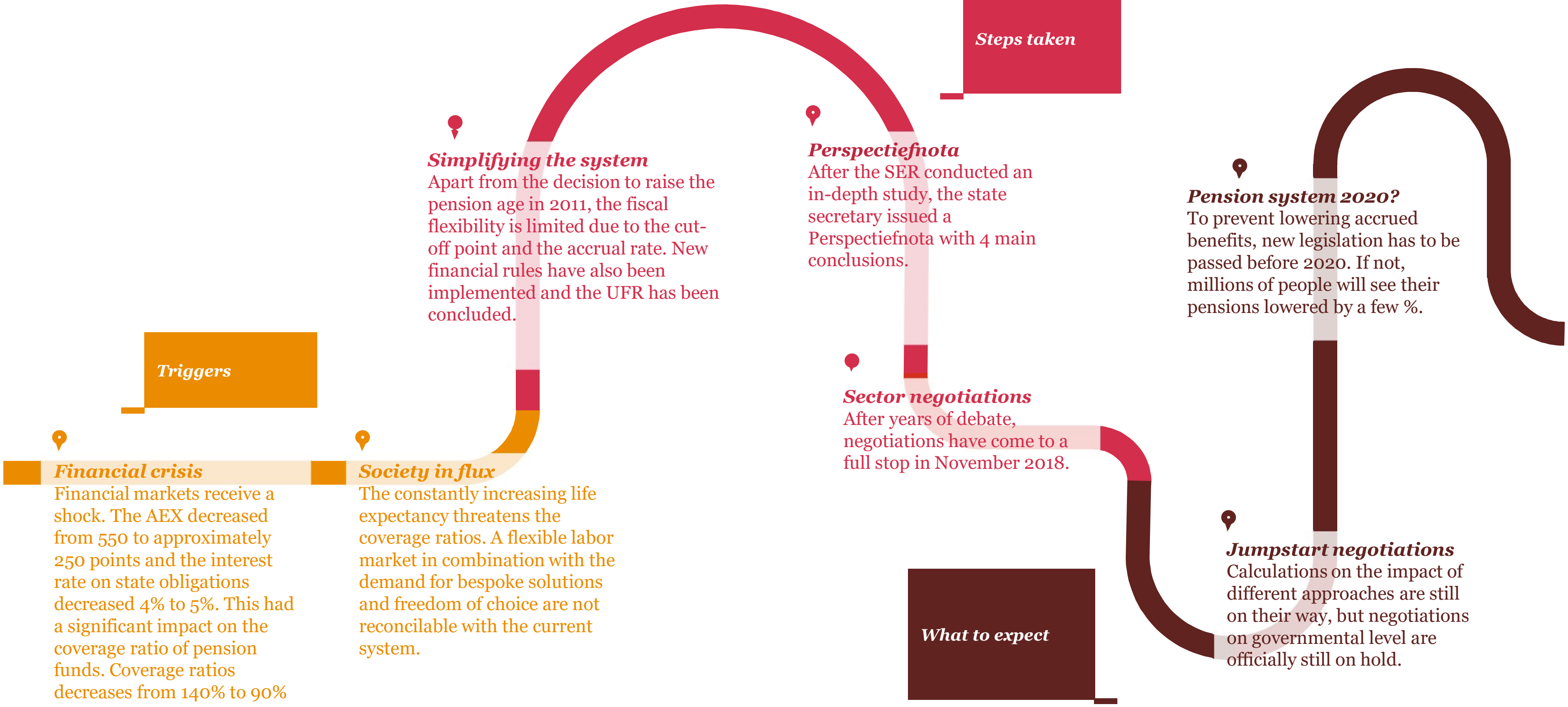
Regulating limited mobility
- Framework fiscal treatment: contributions, pay out, capital gain
- Tightening accounting rules for corporates
- Equal treatment
- Regulation of financial sector

Strong increase in obligations
- Unknown territory interest rate developments
- Low interest rate due to QE-politics and wide availability of capital
- High volatility financial markets
- Search for yield

Erosion of trust
- Financial crisis
- Financial services / institutions
- Governments - pension system
- Changing pensionable age

Flexibility
- Fast changing labor markets
- Technology, urbanization, globalization
- Flexibility versus lifetime employment
- Employer cannot / does not want to incur pension risks

Long-lasting system reform discussion continues to be a source of uncertainty for pension funds



Triggers

Financial crisis
Financial markets receive a shock. The AEX decreased from 550 to approximately 250 points and the interest rate on state obligations decreased 4% to 5%. This had a significant impact on the coverage ratio of pension funds. Coverage ratios decreases from 140% to 90% on average.

Society in flux
The constantly increasing life expectancy threatens the coverage ratios. A flexible labor market in combination with the demand for bespoke solutions and freedom of choice are not reconcilable with the current system.

Steps taken

Simplifying the system
Apart from the decision to raise the pension age in 2011, the fiscal flexibility is limited due to the cut-off point and the accrual rate. New financial rules have also been implemented and the UFR has been concluded.

Perspectiefnota
After the SER conducted an in-depth study, the state secretary issued a Perspectiefnota with 4 main conclusions.

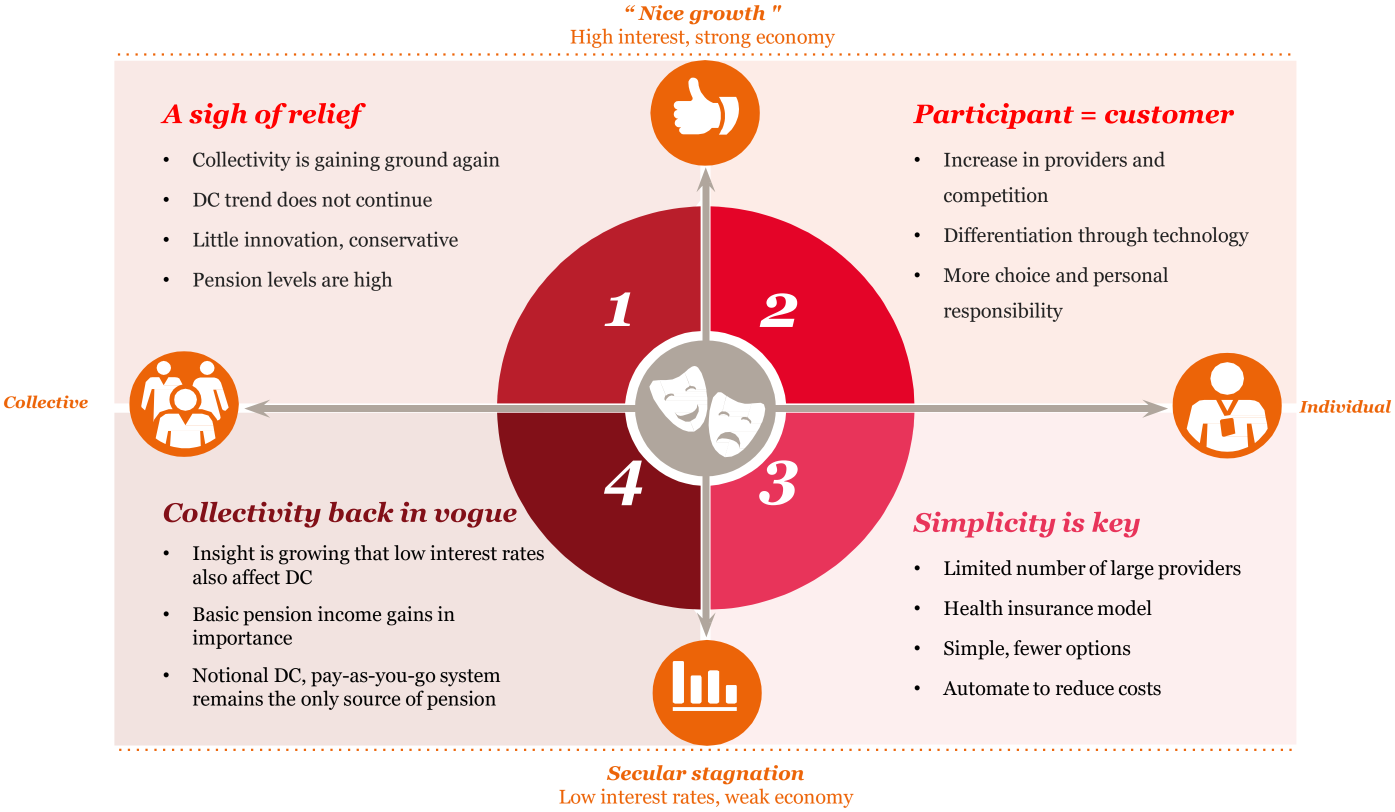
Sector negotiations
After years of debate, negotiations have come to a full stop in November 2018.

What to expect

Jumpstart negotiations
Calculations on the impact of different approaches are still on their way, but negotiations on governmental level are officially still on hold.

Pension system 2020?
To prevent lowering accrued benefits, new legislation has to be passed before 2020. If not, millions of people will see their pensions lowered by a few %.

Scenario planning helps to prepare for the future; Economic growth and sentiment in society are dominant differentiators



" Nice growth "
High interest, strong economy

A sigh of relief

- Collectivity is gaining ground again
- DC trend does not continue
- Little innovation, conservative
- Pension levels are high

Participant = customer

- Increase in providers and competition
- Differentiation through technology
- More choice and personal responsibility

Collective

Individual

Collectivity back in vogue

- Insight is growing that low interest rates also affect DC
- Basic pension income gains in importance
- Notional DC, pay-as-you-go system remains the only source of pension

Simplicity is key

- Limited number of large providers
- Health insurance model
- Simple, fewer options
- Automate to reduce costs

Secular stagnation
Low interest rates, weak economy

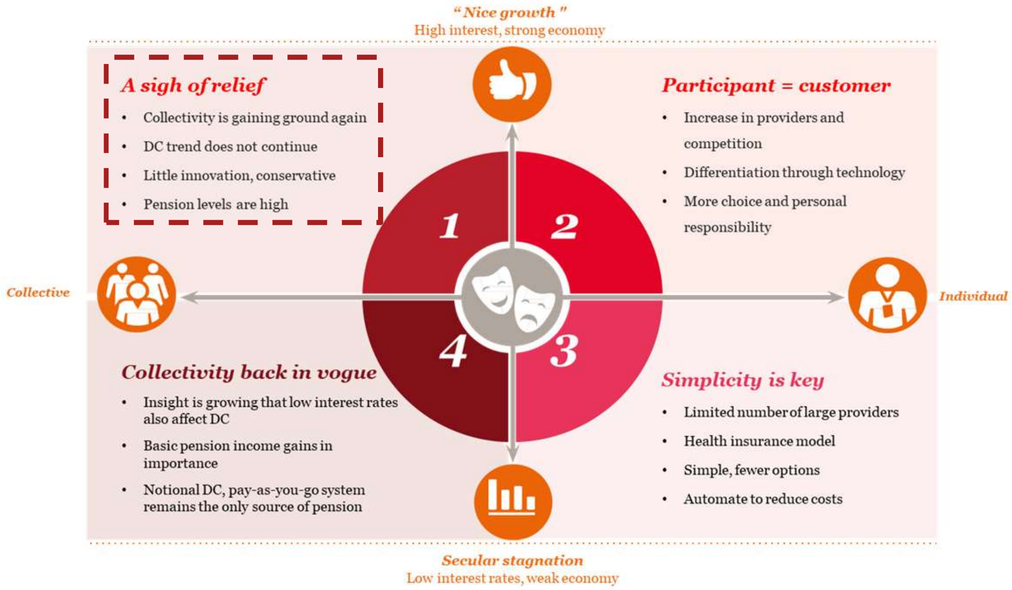
Scenario 1 – A sigh of relief

Scenario

- For years, inflation-adjusted interest rates have been higher than economic growth
- Demographic developments created limited urgency for major reform
- Government only makes limited adjustments just to guarantee the sustainability of the collective system: increasing pension age and introduce DC structure

Impact on the pension system

- Little pressure to change, renew
- The need for new pension vehicles is decreasing
- Few new entrants
- Government remains leading in retirement
- Number of changes continue:
  - Rapid technological innovation; reference framework is "GAFA"
  - Differentiation in the labor market; dynamics of companies / sectors
  - Innovations in business models, advisers, management models
  - More investments in business values, alternatives; hedging real interest rate risk



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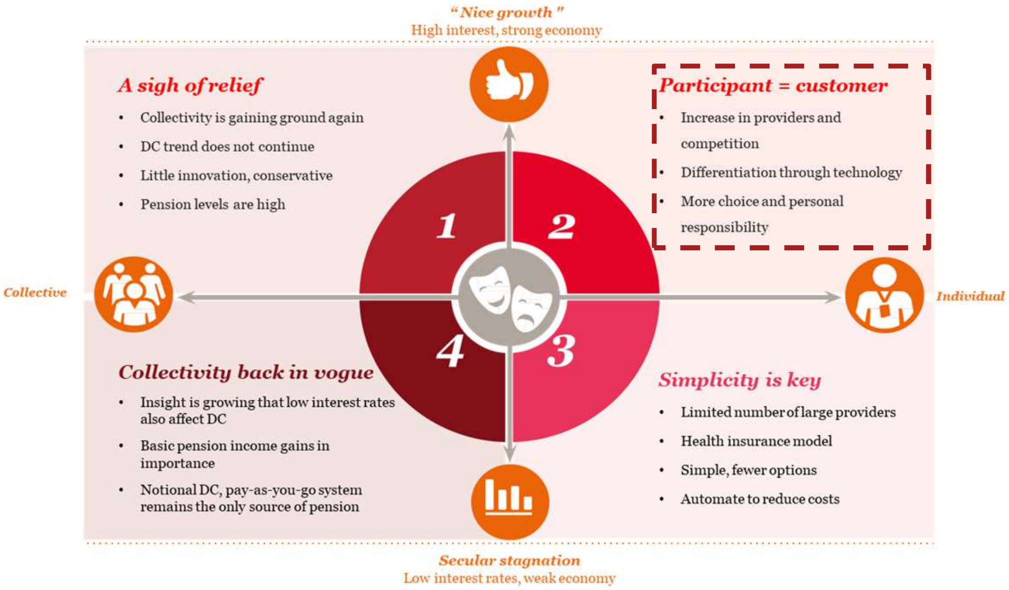
Scenario 2 – Participant becomes customer

Scenario

- Economy is doing well, low unemployment, incomes and prices are rising
- Pensions are in good shape; concerns about individual pension risks disappear
- Workers want self-determination, choice and transparency for their own pension
- Interest in DC schemes with gross or net additions; less collective

Impact on the sector

- Government facilitates transition to new system with rules for: personal pension accounts, capital market investments, duty of care, pension build-up self-employed
- At the choice of the own operator, new providers enter the market, product innovation
- Many opportunities for PEPP like products, insurers with DC scheme experience
- Good position for parties with customer-oriented, personalized services with data analysis, high degree of automation, low costs
- Knowledge of retail (individuals), communication and advice
- Broad approach: capital, income, possession, pension, risks, supplements
- Hybrid form: robo-advise + help / chat function + personal advice
- Investments change to products with flexibility, less focused on the long term



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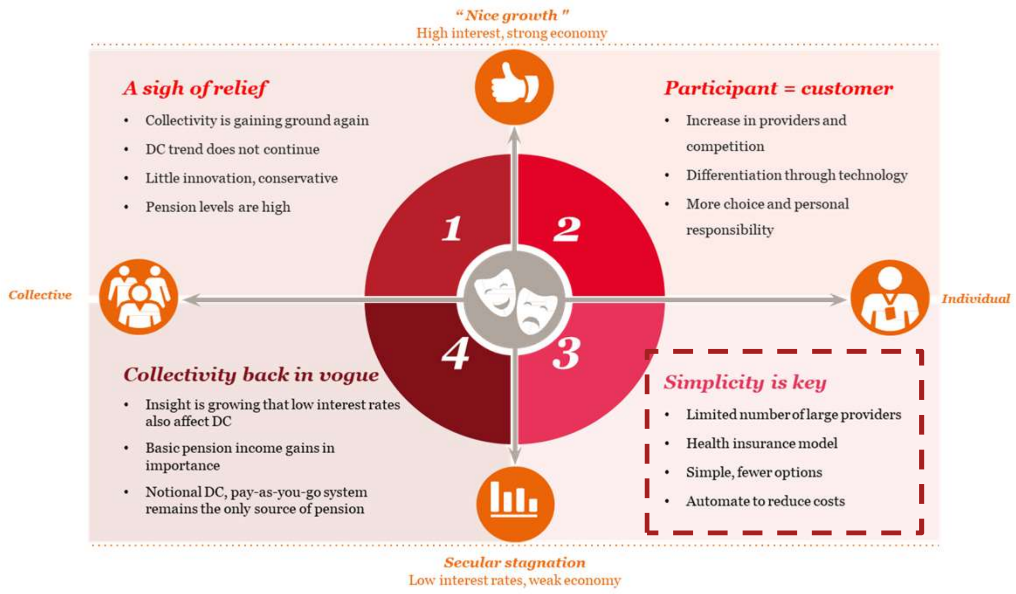
Scenario 3 – Simplicity is key

Scenario

- Inflation is low due to limited activity and modest overcapacity; interest remains low
- Share of non-working people rising, further aging; little growth in labor productivity
- Dissatisfaction with social security and taxation; growth of the grey economy
- Transition to individual schemes to increase insight and trust; people want control over their own finances

Impact on the sector

- Sober standard pension products with little differentiation in the range due to the awareness of high costs
- Limited number of large providers with economies of scale with standard individual schemes
- Health insurer model with standardization, specific freedom of choice and deductible
- Providers focus on individuals / collectivities with a choice; government is market leader
- Investments: short horizon, competition on promised returns; duty of care
- Large players gain ground if they use economies of scale; great pressure on implementation costs
- Use of new technology for administration, data treatment and communication with participants



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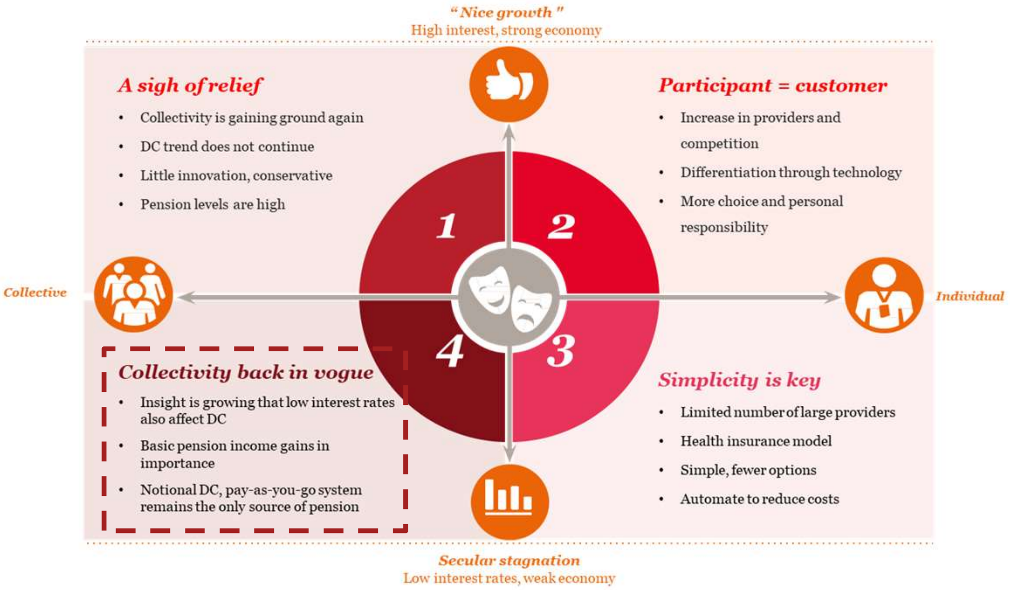
Scenario 4 – Collectivity in vogue again

Scenario

- Due to a limited increase in productivity and overcapacity, economic growth and inflation remain low
- Interest rates remain low and financial markets move more sideways than upwards
- Confidence in the existing system is low; call for alternatives that are fair and realistic
- Insight that collective system yields more than individual pots and that problems do not come from collectivity, but from life expectancy, aging, interest, volatile markets

Impact on the sector

- Employers have no room for additions / setbacks
- Major role of the government
- Movement towards a national pension fund with simple, collective provisions, possibly even one or two sector specific funds
- Pay-as-you-go system or general reserves remain the standard operating model
- Growth of the first pillar at the expense of the second pillar which struggles to gain traction
- Executors are large parties with modern technology, broad focus, relatively simple, standardized forms of pension; emphasis on automation of implementation:
  - robotization of the back office,
  - use of social media for information participants,
  - exchange and processing of data
- Opportunities for niche players with additional schemes



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We see four trends that point to changes from B2B to B2C in the business model of a pension administrator

1

Individualization

- Personal pension capital
- Solidarity discussion
- Bespoke solutions, communication and insights
- Optimal use of knowledge regarding participants

2

Freedom of choice

- Increased mobility expected among employers and employees if the law permits
- Compare other options with products, services, costs, trust and image

3

Customer experience

- Personal, accessible, pleasant and better service
- Attract participants
- Other (digital) service providers are the norm
- Really know your participants (i.e. through internal and external data)

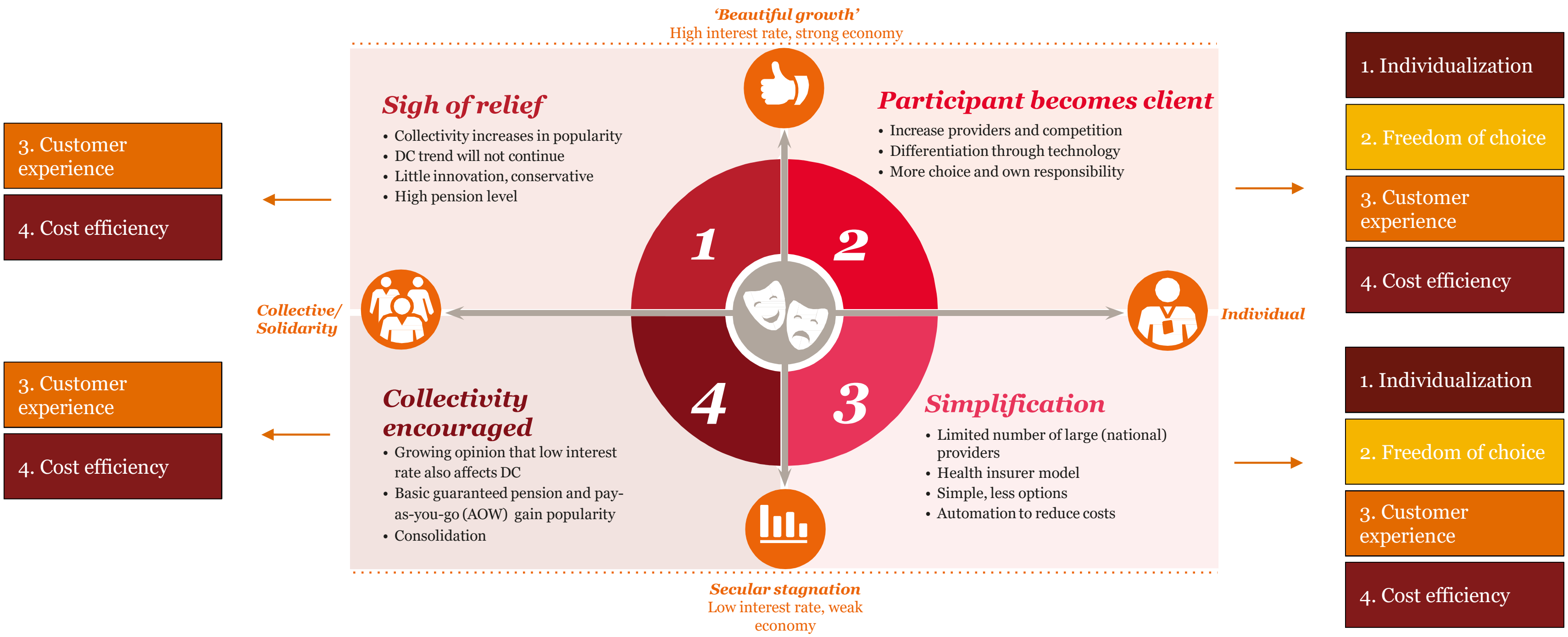
4

Cost efficiency

- Optimal structuring of processes
- (Radical) cost reductions through robotization and sourcing solutions
- Consolidation

These trends are not all applicable to the 4 scenarios described

Improving customer experience and cost efficiency: ‘no regret moves’



‘Beautiful growth’
High interest rate, strong economy

1 ***Sigh of relief***

- Collectivity increases in popularity
- DC trend will not continue
- Little innovation, conservative
- High pension level

2 ***Participant becomes client***

- Increase providers and competition
- Differentiation through technology
- More choice and own responsibility

Collective/ Solidarity

Individual

4 ***Collectivity encouraged***

- Growing opinion that low interest rate also affects DC
- Basic guaranteed pension and pay-as-you-go (AOW) gain popularity
- Consolidation

3 ***Simplification***

- Limited number of large (national) providers
- Health insurer model
- Simple, less options
- Automation to reduce costs

Secular stagnation
Low interest rate, weak economy

3. Customer experience
4. Cost efficiency

3. Customer experience
4. Cost efficiency

1. Individualization
2. Freedom of choice
3. Customer experience
4. Cost efficiency

1. Individualization
2. Freedom of choice
3. Customer experience
4. Cost efficiency

4

Closing remarks

Although the perfect pension system doesn’t exist, there are some global best practices to take note of

The **future of work** is characterized by changing relationships. As pension is an integral part of any remuneration package, it too has to evolve with changing expectations.

No matter which direction a pension system pursues, **governmental guidance** will play an important part. It is up to the government to provide a vision for a future society.

Giving voice to all relevant stakeholders in the debate is of vital importance for a successful pension system. Implementing **good governance** structures is the foundation.

Striking the right balance between PAYGO and capital based pensions, usually found in state and employer pensions respectively, ensures **synergy** between both approaches.

Thank you

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