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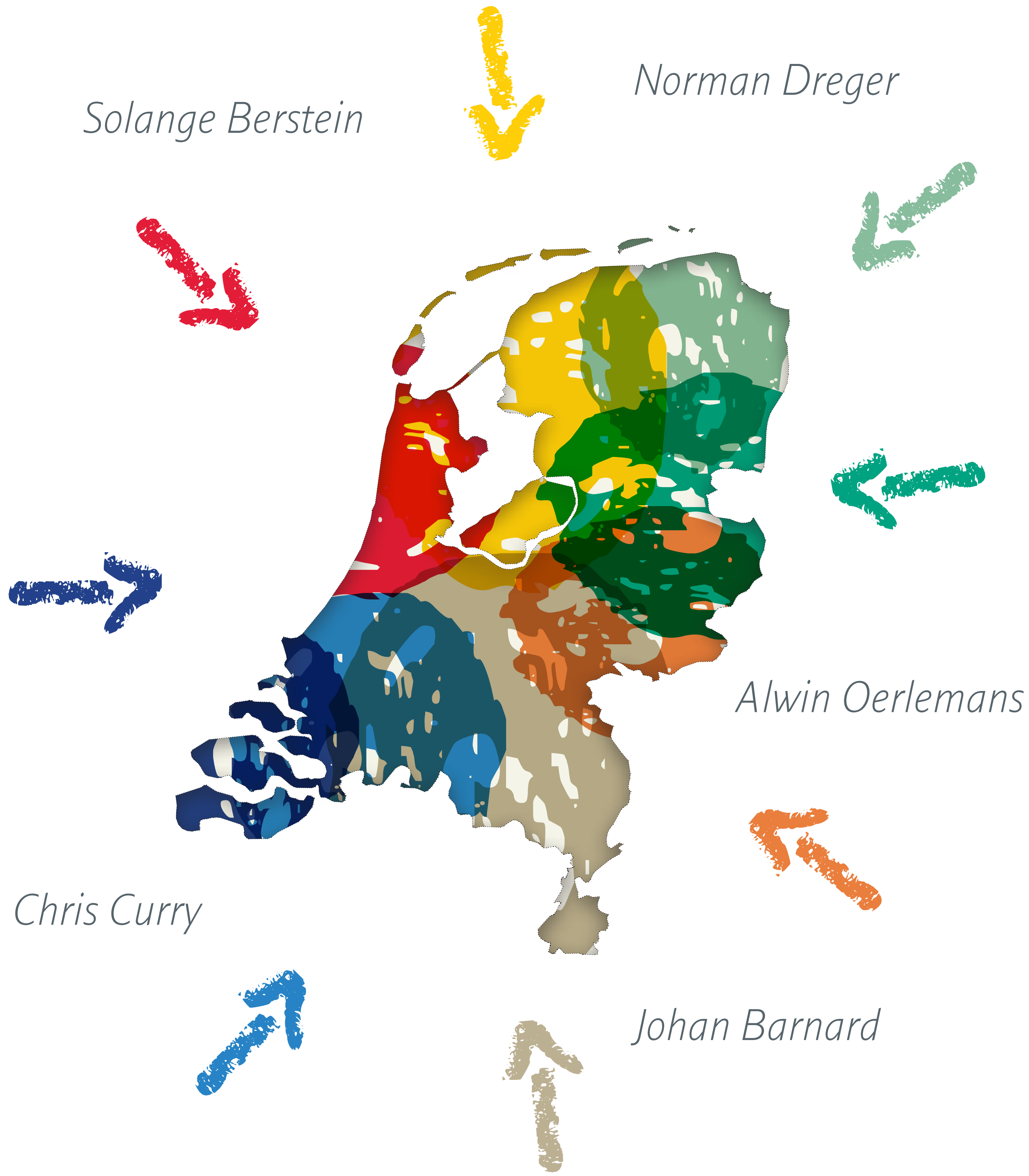
Insights from the outside

An outside view on the Dutch pension system

‘Beware that you can’t put the toothpaste back in the tube. Once freedom of choice is in place, you can’t take it back if it doesn’t work out’, is one of the main warnings of the experts from the UK, Chili and Germany expressed in the APG dialogue meeting on the reforms of the Dutch pension system.



This warning addresses the fundamental shift in our pension system where risks and responsibilities are being reallocated from funds to participants. The Dutch pension debate is for quite some time now centered around the question of whether increased individual choice is a necessary response to increased individual risks and responsibilities. "It provides those who bare the risks of an adequate pension income, with a sense of ownership" according to Solange Bernstein, expert on the Chilean pension reforms from the Inter-American Development Bank. The basic economic idea is that individual welfare increases from having more choice in one's own investment strategy, contribution level and pension provider.

'The 'freedom to choose' is no remedy for risk reallocation if people cannot bear those risks',

is another insight from the experts who have dealt with or studied similar reforms. The Chilean pension reforms are often used as an inspiring example of how reforms could work out well for the pensioners. Solange's insights however, are full of warnings, such as: compulsory saving is not including the self-employed. Chris Curry adds that one should think through the processes that individuals go through in their daily lives. There is a natural moment when the self-employed might be most

tempted to save for their pension. That is for example when they fill out their tax forms and get a rebate. If the online tax forms would include the option of putting aside some of the rebate for pension saving right away, it might trigger the self-employed to do so.

This is what we call a nudge to change individual's behavior. But nudges do not always work out as planned. Strikingly, offering default investment packages to Chilean participants along with the introduction of more freedom of choice, did ***not*** nudge 40 percent of the participants into the default. Those who actively switched out of the default option where in 82 percent of the cases worse off than they would have been in the default option. Here we find another valuable lesson from the Chili experience:

'allowing people to choose their own investment risks is going to make them worse off and nudging alone will not undo the damage'.

Overall, Chilean reforms did not increase the level of pension adequacy. The replacement rate has decreased rather than increased after the reforms. Solange's findings are indeed supporting the insight that is also brought in by Chris Curry from the Pensions Policy Institute in the UK:

'Dont allocate risks with people who can't bear them'

But,

'If you go ahead anyway, make sure you know what you're doing it for. It might get messy and you will need consensus on that being worth everyone's while'

With great amazement, Chris Curry found out that the British government had no other aim in mind for introducing freedom of choice than the notion that: 'whom other than people themselves know best what to do with their money?' "plenty of people" according to Chris, causing a laughter among the participants.

Alwin Oerlemans from APG confirms that people often don't behave in ways that are seen as economically optimal. "Surveys show that contrary to what is expected, young people tend to invest more safely than older people. It would be better for them to do it the other way around"

An international comparison from Mercer's international consulting group presented by Norman Dreger reveals that on a superficial level, some might feel that there is no clear reason why reforms to the Dutch pension system are needed. The Dutch pension system is scoring highest on almost all of Mercer's pension dimensions in terms

of adequacy, sustainability and integrity. However, part of the strength of the Dutch pension system has been the ability to make changes to reflect the changing macroeconomic environment. Pension adequacy is not the only dimension to look at, according to Norman. A system's sustainability is another aim and often a tradeoff with adequacy. Sustainability is challenged by a number of developments such as ageing, longevity and old-age poverty. For future pensioners, benefits are no longer guaranteed. This notion is particularly dissatisfying to people in countries which have had very adequate systems in the past. It's what economists call loss aversion.

'Helping people to manage their risks requires a broad view on financial planning'

APG's Alwin Oerlemans reveals the plans that APG is developing on broad financial planning. Alwin states that because career choices, housing and pension savings are strongly intertwined from an individual's perspective, and because uncertainty is increasing in all dimensions, people need help in their life-time financial planning. Pension providers are ideally equipped to provide this advice at very low or no costs.

This broad and all-encompassing approach fits well into the advice of Chris Curry: because reforming a pension system takes decades rather than years, a broad consensus on each reform and instrument are crucial for success.

Finally, Johan Barnard of APG presented what at first seemed to be an inside view on an outside European plan and not vice versa. As his presentation continued his message for the inside became clear to me, which is:

'Beware of the European Commission's action plan for a Pan European Pension Plan as Gresham's law might apply where bad pensions drive out good ones'

The plan is to initiate a market for a very simple personal pension to those

Europeans that are foreseen to have inadequate pensions in the future. By creating one market for this personal pension plan the Commission also aims to promote cross-country labor mobility and to channel pension savings into long-term investment to help initiate a European Capital Union. According to Johan Barnard to aim for multiple goals with one instrument is problematic, and a wrong ordering of these aims may lead to less good pensions drive out better ones..

Everybody agrees, perhaps also with an eye on the drinks that await us. But before we leave the room, Michiel van Leuvensteijn, who has initiated the dialogue meetings and the articles in this magazine, is being greatly thanked for his efforts in the past years.