Original Article

Pensions crisis in the Netherlands

Received (in revised form): 29th October 2010

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ABSTRACT A number of pension schemes in the Netherlands are considering reducing members' accrued rights and benefits. This article argues that the incorporation into Dutch domestic law of a strict interpretation of the European Directive has something to do with that. The article looks at whether the best intentions of the legislation have therefore contributed to an unexpected outcome, and considers whether this might spell the demise of compulsory participation in Dutch pension schemes.

Pensions (2011) 16, 13–20. doi:10.1057/pm.2010.30

Keywords: pension schemes; EC Directive 2003/41/EC; funding; reduction of accrued rights; participation in pension schemes

The pension system of the Netherlands is experiencing some rough weather. Not only has there been much debate recently concerning the long-term sustainability of the country's funded occupational pension schemes, but much public anxiety has also been aroused by the news in August 2010 that a number of Dutch pension schemes were planning to reduce the accrued rights and entitlements which their members have built up in those schemes. Although the Dutch 'Pensioenwet' (the 'Pension Act') allows pension funds, under certain circumstances, to reduce accrued rights and pensions in payment, such a step is in reality unprecedented and has brought home to the wider Dutch public that their pension system is in a state of some considerable crisis. Given the fact that the Netherlands makes membership of certain of its industry-wide pension schemes compulsory, people might be forgiven for feeling not a little aggrieved at this state of affairs. After all, having effectively been forced to pay member contributions into such schemes whether they like it or not, they now

find that the defined-benefit promise made by their employers is less secure than it appeared. Few in the Netherlands were aware that their country's law allows for pensions in payment and accrued benefits to be reduced: a sense of anger has therefore been created by the news of pending benefit reductions. Even the country's tabloid press and popular media have been reporting non-stop about the issue, even though pensions is not normally a topic that sells many newspapers.

The Netherlands could turn out to become an interesting test-case for the sustainability of defined-benefit pension schemes. Apart from the United Kingdom, few countries in Western Europe have such a developed system of funded, occupational pension provision. Like the United Kingdom, most Dutch employers offer some form of pension arrangement to their employees – but unlike the United Kingdom, many Dutch employers still have some form of defined-benefit arrangement in place for (at least some sections of) their workforce. In recent years, not surprisingly, most employers have switched from offering a final-salary pension arrangement to offering a defined-benefit arrangement based on career-average earnings. According to a

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government commission report, in 2009 as many as 90 per cent of people who were members of a pension scheme in the Netherlands participated in a career-average scheme.¹

The fact that in the Netherlands, unlike in the United Kingdom, there appears to have been less of a switch from defined benefit to defined contribution has a lot to do with the importance the country's political parties, employers and trade unions attach to this form of benefit provision. The Dutch have developed a consensual approach to solving political issues, often by way of tripartite agreements between government, trade unions and employers' organisations. In June 2010, the country's trade unions and employers' organisations reached agreement on a social contract exploring possible reforms to the country's occupational pensions sector.² The social contract refers explicitly to the desire of trade unions and employers to maintain the current Dutch pensions system. At the Dutch general election in June 2010 pensions were also an issue. The country's largest governing party at the time, the Christian-Democratic CDA, stated in its election manifesto that reforms would have to be introduced to the occupational pensions system precisely in order to maintain its defined benefit character.³ The Dutch do not wish to see a wholesale switch from defined benefit to defined contribution, and it is interesting to note that a report issued some years ago by the Dutch employers' organisations used developments on the UK pensions front as a salutary warning of what could happen if the Dutch pension system were left unreformed. Unless the country's defined benefit arrangements were made more financially sustainable, the Netherlands could go the way of the United Kingdom and end up massively having to switch to defined contribution arrangements.⁴

Occupational pension schemes and employers throughout the western world are wrestling with the difficulties of financing retirement benefits for an ageing membership. Nobody today knows with any degree of certainty what the best approach might be to solve this problem in the long term. This article looks at the current problems besetting the Dutch pension system.

How feasible is it to combine a tough funding regime with a statutory 'get-out' for pension schemes to reduce benefits? Where pensions legislation in the United Kingdom effectively prevents employers and trustees of pension funds reducing accrued rights,⁵ the Netherlands does allow for this. But does this make the Dutch pension system more sustainable? Or might the UK model work better, where pension schemes cannot reduce accrued rights and employers have to take final responsibility for funding their pension schemes.

INTRODUCTION

By way of brief introduction, the Netherlands often refers to its 'three-pillared' system of retirement benefit provision. The first pillar consists of the basic state pension that is provided to every Dutch national when they turn age 65. The Dutch basic state pension is financed on a pay-as-you-go basis, but unlike the United Kingdom it is not necessary for recipients of the state pension to have paid national insurance contributions. The third pillar consists of private pension savings. The second pillar covers retirement benefits provided in connection with people's employment, and mainly involves retirement benefits paid out of funded occupational pension schemes.

There are essentially two types of pension funds within the so-called second pillar. The first category consists of normal occupational pension funds, set up by a sponsoring employer within a group or company for the benefit of the employees of such a group or company. Such occupational pension funds are run by a board, consisting of representatives of the employer and the scheme's membership.⁶

The second category of pension schemes is so-called industry-wide schemes (*Bedrijfstakpensioenfondsen*) and profession-wide schemes (*Beroepspensioenfondsen*). What distinguishes both these categories of funds from the standard occupational pension schemes is that membership in these schemes is not voluntary. The Dutch government, through the Dutch secretary of state for Work and Pensions (the 'Secretary of State'), has the power (if requested by

employers' organisations) to issue regulations effectively forcing whole professions and employees in certain industries to participate in such a category of scheme. Clearly, such a degree of compulsion is not entirely uncontroversial in a free society. After all, occupational pension provision is essentially a benefit provided as part of a person's contract of employment, and any individual is free to refuse to enter into a contract. In most cases Dutch law, too, recognises an individual's freedom not to join a pension scheme – and in theory employees are entitled to refuse to join a scheme even if it is made a condition of their contract of employment.

Not surprisingly, proponents of industry-wide- and profession-wide schemes argue that compulsory membership of such schemes has helped to ensure that relatively few people in the Netherlands are without private pension provision. They argue that the pensions-gap in the Netherlands is small compared with countries that largely rely on tax incentives as a means of encouraging a savings culture.⁷ This argument tended to hold up quite well until now, when the threat of benefit reductions has called into question how solid the Dutch pension system really is.

THE LEGAL BACKGROUND

Pension funds in the Netherlands are governed by separate acts of parliament. Occupational pension funds are governed by the Pension Act and industry-wide and profession-wide schemes are subject to separate acts of parliament each. The various statutory provisions are all very similar when it comes to the requirements for scheme funding. This is not surprising: after all, the legal obligations in this area are derived from EU-Directive 2003/41/EC, which imposes a standard requirement on EU-member states to ensure full funding for their occupational pension schemes. The relevant provisions of the Pension Act are therefore comparable to Part 3 (Scheme Funding) of the UK Pensions Act 2004.⁸

The Pension Act sets out the framework for ensuring that pension schemes can have sufficient technical provisions to cover their liabilities. In order to ensure that this is done, schemes must

ensure that they meet a minimum funding requirement (the Dutch statutory equivalent of the 'minimum amount' set out in the EU-Directive⁹), which has effectively been set at 105 per cent.¹⁰ When the funding level of a scheme dips below 105 per cent, the board of that pension scheme has to submit a 'short-term' recovery plan¹¹ to the Dutch Central Bank, which acts as the official regulator of Dutch pension schemes (the '*Regulator*'). Under law, the short-term recovery plan has to set out steps outlining how the pension scheme will restore its funding level to 105 per cent within a period of three years. The Secretary of State can agree to an extension of this three-year limit, where exceptional economic circumstances have led to a situation in which a large number of pension schemes cannot meet the statutory funding requirements.¹² Given the exceptionally difficult circumstances of the credit crisis and the ensuing recession, the Secretary of State granted such an extension in early 2009 by allowing short-term recovery plans to run for five years.

In addition, Dutch pension schemes need to have a buffer in place on top of the minimum funding requirement so as to ensure that there is a 97.5 per cent certainty that pension schemes will not be in deficit within one year as a result of not being able to meet their technical provisions.¹³ The government has stipulated that a funding-level of 125–130 per cent will normally be necessary for schemes to have a proper buffer in place.¹⁴ If a pension scheme is no longer able to satisfy the requirement to have this additional buffer, the Regulator must be notified immediately and a 'long-term' recovery plan has to be submitted.¹⁵ The long-term recovery plan should set out the steps the pension scheme intends to take in order to ensure that the buffer can be in place within 15 years. The Secretary of State can grant an extension of this 15-year limit too, provided there are exceptional economic circumstances as a result of which schemes are in deficit.

Dutch legislators have chosen a strict interpretation of the EU-Directive with tight timeframes.¹⁶ By contrast, in the United Kingdom no distinction is made between

short-term and long-term recovery plans and there is no 105 per cent minimum funding requirement. In the United Kingdom only pension schemes that have funding levels of less than 100 per cent have to submit a recovery plan. Article 17 of the EU-Directive provides that pension schemes need to maintain a solvency buffer where ‘... institutions operating pension schemes, ... and not the sponsoring undertaking, underwrite(s) the liability to cover against biometric risk, or guarantees a given investment performance or a given level of benefits ...’.¹⁷ The fact that the Pension Act, in contrast to the UK equivalent legislation, does insist on a buffer is probably caused by there being no direct legal obligation on Dutch employers as a last resort effectively to guarantee full funding of their pension liabilities. An additional factor might be that (unlike the United Kingdom, which has the Pension Protection Fund) there is no State-run safety net which assumes responsibility for pension liabilities where pension schemes have gone bust. The last resort under Dutch law is in fact the reduction of accrued rights and benefits even where a scheme is not subject to an insolvent liquidation.

The Pension Act therefore puts in place a structure to enable pension schemes, under the supervision of the Regulator, to meet the various levels of funding required by law within set timescales. In order to achieve this, funds are able to pull various levers. These levers include using the discretion not to apply increases to pensions in payment and revalue deferred members’ rights, increase member – and employer contributions as well as making changes to the pension scheme’s investment policy where deemed appropriate. Many recovery plans submitted by Dutch pension schemes will normally contain a combination of such measures.¹⁸

Where pension schemes have exhausted the various alternatives at their disposal and have run out of levers to pull, Section 134 of the Pension Act gives them the nuclear option of reducing members’ accrued rights and entitlements. This is a clear statutory exception to the basic rule under the Pension Act that accrued rights cannot retrospectively be altered.¹⁹ Where the unusual

circumstances of Section 134 do apply, accrued (past service) rights of active and deferred members as well as pensions in payment may be reduced in value. Clearly, the Pension Act does stipulate certain conditions which must be met before such a major step can be taken. The conditions are:

- (a) the pension scheme’s technical provisions and minimum funding requirement cannot be met;
- (b) the pension scheme is not able, within a reasonable period of time, to meet the technical provisions and the minimum funding requirement without disproportionately detrimentally affecting the interests of any one or more categories of active members, deferred members, pensioner members, other beneficiaries under the scheme as well as the employer; and
- (c) all the statutory options at the pension scheme’s disposal (except adjustments to the scheme’s investment policy) have been tried as part of the short-term recovery plan but have failed to bring the pension scheme back up to the minimum funding requirement.

The pension scheme is under a statutory duty to inform all affected parties, as well as the Regulator, in writing about any decision to reduce accrued rights and benefits. Any actual reduction of such rights and benefits can only be implemented at the earliest one month after the affected parties have been informed in writing.²⁰ (It is also a moot point whether the Pension Act is overriding on this point or whether pension schemes actually need to have a specific power in their scheme rules to be able to reduce accrued rights²¹ – but this is a technical issue which goes beyond the scope of this article.)

The law does not link benefit reductions to any specific obligation on the employer to provide additional funding – although it does effectively presuppose that everything has been tried unsuccessfully within the parameters of a short-term recovery plan to bring the pension scheme back up to 105 per cent funding. Academic commentators have pointed out that the legislator clearly intended schemes to reduce

benefits in accordance with Section 134 only in exceptional circumstances, effectively as a last resort²² – this is confirmed by the official government commentary on the Pension Act issued at the time it became law.²³

When in August 2010 news reached the press that a number of unnamed schemes were intending to make use of the statutory power to reduce benefits and accrued rights under Section 134, a massive row erupted. Many members of pension schemes reacted with understandable anxiety at the news, especially given the fact that no-one knew which schemes would be affected, and how badly.

Many commentators in the press, as well as representatives of pension schemes, were inclined to blame the government in part for the problems that pension schemes were going through. The legal requirement for pension schemes to use the Dutch Central Bank's base rate to assess their future liabilities,²⁴ they argued, was crippling pension funds. The historically low level of interest rates caused by the recession was forcing pension schemes to assume an unrealistically low level of return on their assets, indirectly tipping them into deficit. If this particular corset could be loosened, they argued, schemes might not actually be in deficit at all. After all, once the economy had moved permanently out of recession, interest rates would surely rise and future pension liabilities would become less expensive. There is certainly a credible argument to be had about this, and it perhaps highlights how strict government regulation has played a part in bringing about the current pension crisis in the Netherlands. Perhaps if anything this shows that a funding regime which might be too stringent can end up having the opposite effect of that intended by the legislators.

THE FACTUAL BACKGROUND

Like all countries, the Netherlands was affected by the credit crisis and subsequent recession that enveloped the industrialised world from late 2007/2008 onwards. By early 2009, it had become clear that most of the country's defined benefit schemes had moved into a state of

underfunding. Following the provisions of the Pension Act, the statutory obligation on pension funds to draw up a short-term recovery plan for submission to the Regulator was duly triggered in a majority of cases. Given the severity of the economic crisis, the Secretary of State decided to grant pension funds an additional period of grace to achieve the required 105 per cent. Instead of the usual three-year period, pension schemes were now allowed to draw up short-term recovery plans with a time span of five years.

The official ministerial order made it clear that pension schemes that had already decided to implement benefit reductions by 1 August 2010 would also be given an extension: they would not have to make such reductions before 1 April 2012.²⁵ Pension schemes that had not decided to implement benefit reductions would be given an extension in respect of their short-term recovery plans of two years: in other words, they would now have five years in which to attain the minimum funding requirement of 105 per cent. The thinking behind this was precisely to avoid leaving schemes no choice but to resort to benefit reductions, something which would be more likely if schemes were forced to meet the tougher test of recovering a funding level of 105 per cent within three years.²⁶

But there was a sting in the tail. The official ministerial order extending the timescales for the short-term recovery plans made it clear that the Secretary of State would be reviewing the situation by no later than July 2010, taking advice from the Regulator. The Secretary of State would obtain the views of the Regulator and then have to decide whether the timescale extensions were still justified in light of the financial position of the pension schemes at that point.²⁷ In other words: the extensions were always conditional. If it were to appear to the Regulator by July 2010 that at that stage schemes were unlikely to reach 105 per cent funding within five years, the extension of the statutory timescales would be withdrawn. If this were to happen, clearly, the unpalatable benefit reductions would have to be brought forward again. Scheme members who believed that no benefit reductions would be implemented before 1 April 2012 at

the earliest would be confronted with an uncomfortable truth pretty suddenly.

In July 2010 the Regulator provided official confirmation of its review to the government. In an official letter to the Secretary of State dated 30 July 2010 the Regulator made it clear that most pension schemes were not on track to return to the required funding levels, even with the extended timeframes for their short-term recovery plans. The Regulator feared that those pension schemes might not be able to escape having to reduce accrued rights and benefits, even after five years. Allowing schemes to continue putting off this evil moment would therefore be irresponsible, as it would simply lead to potentially worse reductions having to be made further down the line – when schemes' funding positions might have deteriorated more significantly. This would place an unfair burden on schemes' active members, who would run the risk of seeing their member contributions increased as well as having potentially significant benefit reductions imposed. The Regulator did recognise that a decision to withdraw the extended timescales might virtually force schemes to start reducing benefits, thus undermining confidence in the entire Dutch pension system. However, the Regulator made it clear to the Secretary of State that this was effectively Hobson's choice: doing nothing could equally undermine confidence. The message was: not acting now simply stores up more trouble for the future.²⁸

Following this report from the Regulator, the Secretary of State wasted little time before acting. On 17 August 2010 he confirmed that the extension of the timeframes announced in 2009 would effectively be discontinued at once, although pension schemes would be given a short period of grace until 1 January 2011 before having to start implementing any benefit reductions. The period of grace had been alluded to by the Regulator as being necessary for the relevant pension schemes to be given some breathing space.

The official commentary on the ministerial announcement made it clear that the government had concluded that accepting further delay would

worsen the financial position of pension schemes: by effectively forcing pension schemes, where necessary, to start reducing benefits sooner rather than later the government hoped to avoid seeing a further deterioration. If pension schemes could show during the period of grace that their funding position was significantly improving, they would be free to scrap any benefit reduction measures which they had initially considered.²⁹

WHAT NEXT?

When the ministerial announcement was made, the press in the Netherlands went into great convulsions of excitement. Panicky articles appeared blaming the government for ostensibly imposing benefit reductions on pension schemes. The main problem was that the government, for reasons of confidentiality, could not announce which pension funds might actually implement benefit reductions. They only mooted that 18 pension schemes would be affected. Not surprisingly, this led to fevered speculation as to the identity of the 18 funds in question. Slowly, one by one, the pension schemes themselves revealed that they were among those considering applying benefit reductions – although many hastened to add that this was by no means a foregone conclusion.

Once the dust began to settle, it turned out that 14 pension schemes were affected. Of these, two were large profession-wide funds (for chemists and notaries) and two were large industry-wide funds (for notaries' support staff as well as for workers in the metal industry). The other 10 were smaller occupational pension schemes.³⁰ These pension schemes have to consider whether they now wish to implement benefit reductions, or whether they want to try to improve their funding level in the run-up to 1 January 2011 sufficiently for the Regulator to agree that benefit reductions do not have to be implemented. Members of the affected pension schemes can only wait and wonder, although there have since been reports that some schemes are now reconsidering their decision to cut benefits and accrued rights.

A BETTER WAY?

As mentioned above, the Pension Act does not of itself impose benefit reductions – it simply allows pension schemes to implement such reductions as a measure of last resort. Alternative ways to improve a scheme's funding level first have to be explored, including contribution increases and non-indexation of pensions in payment. Only once such options have been tried but failed to bring a scheme back up to 105 per cent, can pension schemes consider reducing accrued rights and entitlements. They can only do this if not doing so would lead to any class of beneficiaries (including the employer) being disproportionately detrimentally affected. The law therefore seems designed to avoid scenarios where either members or employers would disproportionately end up having to shoulder the financial burden for restoring schemes back to financial health.

It is clear that the Pension Act does not intend benefit reductions to be a soft option or an easy way out. But despite that, some strange anomalies might still result. In practice there is little to prevent a scheme moving to the conclusion that benefit reductions are the only option left, especially as Dutch legislation does not impose an actual obligation on employers to make good a deficit in their pension schemes. Unlike the situation in the United Kingdom, pension schemes in the Netherlands do not have the benefit of being able to enforce a 'debt on the employer' in respect of their underfunded schemes. This can lead to the paradox where Dutch pension schemes might feel compelled to reduce their members' accrued rights and benefits without probing their sponsoring employers' ability to make further funding commitments.

It therefore seems that Dutch legislation is more employer-friendly (or perhaps member-unfriendly) on this point than the United Kingdom, where reductions to pensions in payment and accrued rights payable from an ongoing scheme cannot be implemented other than with the consent of the members affected. The UK pension system adheres to the principle that an employer cannot walk away from its financial obligations towards the defined benefit

occupational pension scheme it is sponsoring. Only where an underfunded scheme has to wind up because the sponsoring employer has become insolvent, can *de facto* benefit reductions be imposed as a result of a statutory priority order being applied. But even in those circumstances, members of UK pension schemes have some comfort of knowing that their schemes are (for the most part) eligible to be assumed by the Pension Protection Fund. Under the Pension Protection Fund the benefits of most pensioners, at least, are fully protected.

An important contributory factor to the Dutch pensions crisis of August 2010 is the strict interpretation that is given to the EU-Directive. The minimum funding level that pension schemes have to achieve is 105 per cent; leaving aside the extra buffer of 130 per cent that is required if a scheme is to avoid having to submit a long-term recovery plan. The Regulator does police these funding norms in a strict way, presumably on the principle that sparing the rod would spoil the child. But again, how sensible is it to force schemes to implement short-term recovery plans in order to achieve a funding level of 105 per cent within three years? Compared with the United Kingdom, this is a pretty stringent approach. The UK Pensions Regulator has allowed recovery plans to run for a period of 10 years or more for schemes to move back to a funding level of 100 per cent, and in almost all cases this will involve the sponsoring employer having to make additional payments into the pension scheme on top of the normal employer contributions.³¹

It is difficult, of course, to predict which approach ultimately stands the best chance of succeeding. Some pessimists might argue that all defined benefit schemes are ultimately doomed due to the twin pressures of ageing and financial constraints on employers. Only time will be able to tell. In the meantime, defined benefit pension arrangements (however modest) still seem to be the norm rather than the exception in the Netherlands. Dutch trade unions, employers and politicians will wish to be seen to be trying to save their country's defined benefit pension schemes, even though this will almost certainly

involve making benefits less generous over time. But will this be enough? One does have to wonder whether a system which in many ways compels people to participate can then withstand the criticism that inevitably results when benefits are cut. Following the events of August 2010, there have already been rumblings of discontent within the Netherlands about compulsory participation in pension schemes.³² Maybe the demand will grow stronger that people be allowed to buy their own pension product, rather than be enrolled in an arrangement with no effective choice to opt-out.

Is there a better way? Is the alternative to possible benefit reductions a statutory obligation on sponsoring employers to treat their pension scheme's deficit as their own debt? Surely that option, too, is currently being tested to destruction in the United Kingdom, where increasing numbers of employers are shutting down defined benefit pension arrangements. The next years will have to show whether defined benefit pension provision can survive, even in a modified form. The events in the Netherlands of August 2010 show that there are no easy answers and the debate is likely to continue for some time to come.

REFERENCES AND NOTES

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- 9 See Article 15.4(a) of Directive 2003/41/EC.
- 10 See Dutch Government's note on Pension Act: *Memorie van Toelichting* (2005), p. 89.
- 11 See for this Sections 131 and 140 of Pension Act.
- 12 See Section 142 of Pension Act.
- 13 See Section 132(2) of Pension Act.
- 14 As note 10 above; p. 90.
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- 16 See for this an interesting article: by A van Damme and others: *Europese pensioenfondsen in zwaar weer. Een Belgisch-Brits-Nederlandse kijk op de zaak*. In *Tijdschrift voor pensioenvraagstukken*, August 2009.
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- 18 See for example the recovery plan of the ABP, the largest Dutch pension scheme – as published on their website.
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- 20 See Section 134(3) of Pension Act.
- 21 See Section 35 Pension Act.
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- 24 See Besluit Financieel Toetsingskader pensioenfondsen, Article 2.
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- 27 See Section 6a(6) of *Regeling Pensioenwet*.
- 28 See letter of Regulator to Secretary of State; 30 July 2010 (esp.p.2).
- 29 See ministerial announcement in *Staatscourant* Nr 13134 of 20 August 2010.
- 30 The complete list is helpfully mentioned in an article by Professor Erik Lutjens: 'Korten op pensioen?' in *Pensioen & Praktijk*, nr. 9 (September 2010).
- 31 See for the UK situation the Pensions Regulator's Code of Practice 03: 'Funding Defined Benefits'.
- 32 See for an example an article to this effect in the weekly news magazine *Elsevier*, NR 41, 16 October 2010 'Waarom kan ik mijn pensioen niet zelf regelen?' (Freely translated: Why can't I take care of my pension in my own way?).