Going Dutch on pension reform

By Editor Test *Wed, Jun 26, 2013*

Dutch workers both young and old now expect smaller pensions than their current retirees enjoy. But their expectations may need to drop even lower if the "tax-facilitated accrual rate" falls to 1.75% a year from 2.25% under pending pension reform.

The Netherlands' deadline for overhauling its rules for private pensions with a new "Financial Assessment Framework" (FTK) has been pushed back to January 1, 2015, due to the complexity of the changes. But in the meantime there's been lots of debate over it and how it might affect workers.

Expectations for retirement have changed in the Netherlands. Dutch workers both young and old expect smaller pensions than their predecessors. But their expectations may need to drop even lower if the "tax-facilitated accrual rate" falls to 1.75% a year, according to an *IPE.com* report based on interviews with the VvV, or Dutch Association of Insurers.

In 2012, the Netherland's new government announced a measure that included a reduction in tax-advantaged pension accrual rate to 1.75% per year of service and tax-facilitated pension accrual would no longer be possible above an income of €100,000, according to a report by Ernst & Young.

As a rough example, the pension of a Dutch worker who had a final salary of €50,000 (One euro = US$1.30) after 40 years would be €35,000 (1.75% x 40 x €50,000), while at 2.25% the pension would be €45,000. The highest tax-facilitated pension accrual would be €70,000 after 40 years on the job.

So far, the pensions would like a compromise between the old and new rates. The civil service scheme ABP and the unions FNV, CNV and MHP, as well as the VvV, have called on Parliament to allow for a 2% pensions accrual to ensure young workers receive adequate pensions.

Dutch employees between 18 and 35 years of age expect to receive 64% of their final average salary in retirement, according to a survey of almost 1,000 consumers by the polling firm GfK on behalf of the VvV. But they may need 74%, VvV said.

Suggested government proposals to decrease the yearly accrual rate to 1.75% from 2.25% will hit young people particularly hard, even if promised permanent compensation measures lift the new rate to 1.85%, studies have shown.

Dutch workers over 50 believe they will require 79% of their average salary in retirement, yet the VvV estimates that they will receive on average 69% at most. Among young employees, 79% said worried that their pension might be under 50% of their average salary; while 76% of older workers said this was a threat.

Both age groups expect to retire at 65.5, on average; less than 8% expect to work until 70, GfK found. But 31% of the younger generation and 25% of older workers said they would need a part-time job after retirement.

The government should not “economize” on pensions but rather reduce the civil service headcount, cut back on Social Security benefit, or reduce the mortgage interest tax break.

Nearly 70% of surveyed young workers said it made little sense for them to carry on working until the age of 72, assuming the Dutch Cabinet’s plans on the retirement age are embraced by Parliament.

Generational conflict

The Dutch pension system has another problem that prevents the government from overhauling it: younger plan members subsidize older members by means of an average contribution rate. So said professor emeritus Jean Frijns at a recent conference in Amsterdam.

“The average contribution methodology is the elephant in the room,” he said. “And, so far, everybody has been giving it a wide berth. This is a relic from the past. It amounts to a considerable chunk of pay-as-you-go financing hidden in our system of capital funding.”

Young plan members presently pay higher contribution premiums, which he said could be seen as pay-as-you-go subsidies to older scheme members. “The moment a scheme is closed to new members, this creates a pension deficit for older workers,” he said.

“I don’t see how they can close that cap in the 10-15 years that remain for them before retirement. This is a tremendous risk we are depositing at the doorstep of a particular group of workers.”

Government plans to limit fiscally facilitated pension savings are now bringing the problem into sharper focus. “This means 20% of pension funds are being closed off,” he said. If the proposed FTK favors current retirees, older active plan participants would be at a disadvantage.

“Pension funds have implicitly promised to treat all scheme participants equally, so the problems caused by this average contribution methodology must be solved together, with the pain borne by pensioners, older workers and younger workers alike,” he said.