Going Dutch, with a DB-DC Hybrid

By Kerry Pechter *Thu, Nov 20, 2014*

Can the use of "buffers" in collectively-managed defined contribution funds offer defined benefit-like income predictability? In the Netherlands, where pensions are a passion, a team of business, academic and governmental experts is recommending it.

A new plan for reforming the Dutch pension system would combine the best features of individual accounts and collective risk-sharing methods or "buffers," according to *Pensioen Pro*, an affiliate of IPE.com.

The plan would take advantage of a new freedom that Dutch pension architects enjoy. They no longer have to adhere to a nominal funding rate, so they can create custom solutions that match the needs of their participants.

The plan reflected a compromise among pension experts who don't normally agree: academics, a political activist, regulators and representatives of APG and PGGM, two giant Dutch workplace pensions.

Netspar, the pension think tank, had encouraged the experts to work on a compromise. Their proposal will become part of a 'national pensions dialogue' organized by the Dutch Department of Social Affairs and Labor.

Under the proposal, the guarantees that are typical of defined benefit arrangements are replaced by transparent information regarding the pension benefits that participants might expect—but without the guarantees.

Individual retirement accounts would show each individual's savings, including contributions and investment returns. The individual accounts would also reflect any insurance premiums paid, such as disability insurance.

Collective capital buffers would offer protection from market shocks. The buffers would be funded during times of high investment returns, while participants would receive payments from the collective during times of negative investment returns.

Participants would replenish depleted buffers over time through 'recovery contributions,' allowing shocks to be spread over generations. Other collective features would be retained, including shared investment and benefits administration. Each pension fund would be able to decide which risks participants should share.

Macro longevity risks and inflation risks might be shared, for instance, and, in extraordinary circumstances, pension fund trustee boards may be given the authority to effect a wealth transfer. The use of individual retirement accounts, meanwhile, would show each participant exactly how much these forms of solidarity would cost.

Contribution levels would remain constant throughout a participant's lifetime, while investments would be tailored according to lifecycle principles, with the important option to continue allocating to risk-bearing investments after retirement.

Other specifics of the proposal include:

- Investments would be organized collectively for benefits of scale, but allowing for some individual choice, particularly concerning risk profile.
- Because pension funds are no longer bound by the need to maintain a set nominal funding rate, schemes would be able to cater to their participants' investment needs.
- Plans would work toward a target benefit level.
- Premium contribution levels would consider expected returns.
- Participants would be offered a choice in terms of benefits – receiving higher benefits initially and then tapering off, for instance.
- During the payout phase, participants may buy annuities from the fund, while the fund itself invests to fund these annuities.
- As the scheme remains invested in equities, the risk level will be a bit higher, so annuities are not 100% guaranteed.
- Alternatively, participants may choose to pay out their own benefits from their individual account.
- If they should die prematurely, their savings account will be absorbed by the collective, which uses the money to fund benefits for those who live longer than expected.

The academics have published their proposal ahead of a nationwide review of the existing pensions system.

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