In the Netherlands, DB plans said to out-deliver DC plans

By Editorial Staff *Thu, Dec 8, 2016*

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Thanks to risk-sharing and the hedging of interest risk on liabilities, defined benefit (DB) plans in the Netherlands can achieve 20% better outcomes at retirement than individual defined contribution (DC) plans, according to the Dutch Bureau for Economic Policy Analysis (CPB).

The CPB had compared two options for a new pensions contract at request of pensions think-tank **Netspar**. The options were "collective DB" without guarantees and individual pensions accrual with shared investment risk, as well as individual DC contracts without risk-sharing.

The options were proposed by the **SER**, a panel of employer and employee representatives and academics that advises the Dutch government on social and economic policy. The news was first reported by IPE.com.

Seven percentage points of the extra return produced by DB plans were due to shared investment risk between current and future generations, which enables DB schemes to take on more investment risk, said Marcel Lever program leader at CPB.

The remaining 13 percentage points came from a 25% interest hedge through swaps, on top of the interest cover through bond holdings. With interest swaps, pension funds always receive the long-term rate and pay the short variable rate, Lever said.

"At individual contracts, it is uncommon to hedge interest risk this way. Because the long rate is almost always higher, this construction delivers an additional return of 1.5% on average in the long run," he said. "In most of our scenarios, a hedge of between 60% and 100% is beneficial."

Lever said it was still unclear whether an interest hedge would also apply to a pensions contract based on individual accrual with risk-sharing. "The question is whether all participants with individual contracts could provide sufficient collateral such as AAA bonds," he said.