Retirement Income
JOURNAL

Why high returns leave Dutch DB plans unhappy

By Editorial Staff *Thu, Nov 14, 2019*

'As the high returns are largely due to dropped interest rates, the rosy figures will in part disappear as soon as interest rates rise again,' said a Dutch pension consultant.

Despite enjoying solid returns since the financial crisis, Dutch defined benefit pension funds are still tormented by low interest rates and expect lean years ahead, according to a report this week at IPE.com.

Citing a survey of the 100 largest DB plans by the Dutch financial daily Het Financieele Dagblad (FD), IPE reported average returns of 10% for the past 10 years; in the first three quarters of this year, the five largest pension funds reported returns of 15.1% to 19.1%.

For instance, the €1bn hairdressers plan (Kappers) averaged 10% growth during the past five years and posted the best result (2.3%) for 2018, the FD survey found. But ever-falling rates, which the funds use to discount their future liabilities, have undermined their funding ratios.

Gerard van de Kuilen, the pension fund’s chair, said Kappers’ funding ratio funding fell to 93.8% as of September 30, forcing the plan to contemplate benefit cuts in the absence of higher contributions.

The plan’s positive investment returns were due mainly to its 50% interest hedge of its liabilities through interest swaps and bonds, whose solid results were due to declining interest rates, he said, adding, “But this is something you don’t want.”

Van de Kuilen explained that, because of its young participant population, the liabilities of Kappers have a duration of no less than 34 years so that “a 1% drop of interest rates means a rise of liabilities of 17%.”

Similarly, the €459bn civil service plan ABP posted returns of more than 15% for the first three quarters of 2019, with equity, bonds and private equity yielding 21.9%, 11.4% and 11.1%, respectively, while real estate generated 16.2%, according to Diane Griffioen, the plan’s head of investment. But its funding ratio was only 91% as of September 30.

Simon Heerings, director of risk management at consultancy First Pensions, said most Dutch schemes face the same challenges. “Low rates generate insufficient returns relative to rising liabilities," he said. "As the high returns are largely due to dropped interest rates, the rosy figures will in part disappear as soon as interest rates rise again."

"I keep on seeing pension fund trustees and media referring to record returns and pension assets, but they deliberately ignore the liabilities side of the balance sheet," observed Rob Bauer, professor of finance at Maastricht University.

Most Dutch pension investors expect much lower returns during the coming years, according to a survey among 10 fiduciary managers by Dutch consultancy Sprenkels & Verschuren.

Average returns for equity and credit would drop to 4%, 3% and 0%, respectively, for the next five years, the managers predicted. Part of this year's returns reflected a rebound from losses incurred during the last quarter of 2018, said ABP's Griffioen.